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the Supreme Court of the United States

OCTOBER TERM, 1945.

No. 455

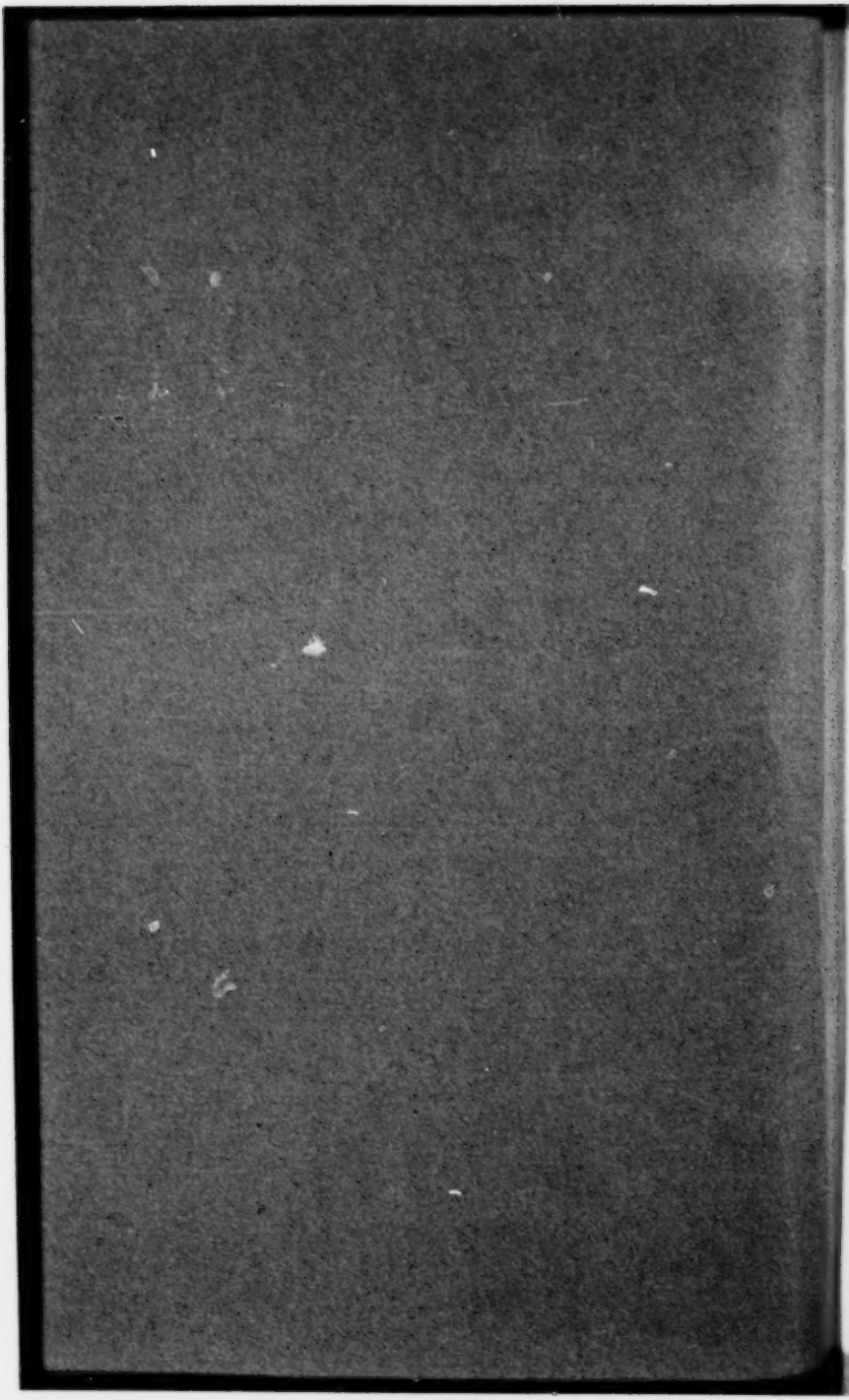
S. LIVINGSTON MATHER,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit
and
BRIEF OF PETITIONER.

JOHN B. PUTNAM,
EDWIN A. HOWE,
Union Commerce Building, Cleveland, Ohio,
Counsel for Petitioner.



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PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals for the Sixth Circuit.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

S. Livingston Mather prays that a writ of certiorari issue to review the judgments of the Circuit Court of Appeals for the Sixth Circuit entered in this case on May 23, 1945 and July 2, 1945, respectively. Said judgment entered on May 23, 1945, affirmed the judgment of the Tax Court of the United States in favor of respondent and against petitioner relating to petitioner's federal income tax liability for the year 1939. Said judgment entered on July 2, 1945, denied petitioner's petition for rehearing and reargument of this case.

* This case involves substantially the same facts and the same issues as those involved in Testamentary Trust u/w of Samuel Mather, deceased, v. Commissioner in which a petition for a writ is being concurrently filed.

JURISDICTION OF THE COURT.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; U. S. C., Title 28, Section 347 a) and Section 1141 of the Internal Revenue Code (53 Stat. 154; U. S. C., Title 26, Section 1141).

STATUTE INVOLVED.

The statute involved is Section 23 (k)(1) of the Internal Revenue Code, the relevant part of which reads as follows:

> "Sec. 23. In computing net income, there shall be allowed as deductions:
>
> * * * * *
>
> (k) Bad Debts.—
>
> (1) General Rule.—Debts which become worthless within the taxable year; * * *"

STATEMENT OF THE MATTER INVOLVED.

The facts are all stipulated. They show, and it is conceded, that during 1939 petitioner, S. Livingston Mather, paid from his own funds approximately $120,000 on his accommodation obligation on a promissory note to Cleveland banks on which Robert H. Bishop, Jr., was the primary obligor; that a debt from Bishop to petitioner arose from such payments; that at the time the accommodation obligation was undertaken "no gift was made or intended"; that during 1939 Bishop was insolvent and unable to pay anything on any unsecured obligation; and that petitioner took a deduction in his income tax return for 1939 for the debt from Bishop to him which thus arose and became worthless in that year.

Petitioner's apparent right (under the provisions of Section 23 (k)(1) above quoted) to a deduction for such worthless debt was, however, denied by the Tax Court and the Circuit Court because they said that the stipulated

facts were the substantive equivalent of a theoretical situation under which petitioner would not himself have made such payments or acquired such debt and that petitioner's right to such deduction must be controlled by such theoretical substantive equivalent of the stipulated facts.

The following background facts, which were stipulated without question as to their actuality, are also involved in the issue:

Petitioner is the son of Samuel Mather, deceased (herein called "Mather"). Prior to June 1, 1931, Robert H. Bishop, Jr. (herein called "Bishop"), Mather's son-in-law, maintained certain brokerage accounts. During the period from September 29, 1930 to April 14, 1931, Mather loaned Bishop various securities which were used by Bishop to collateralize his indebtedness under such accounts. (R. 36.)

On June 1, 1931, Mather, for the accommodation of Bishop, joined with Bishop in executing and delivering to The Guardian Trust Company of Cleveland, Ohio, a note (herein referred to as the "Accommodation Note") in the principal sum of $3,566,000. The entire proceeds of this note were disbursed by The Guardian Trust Company in payment of Bishop's indebtednesses. (R. 32-34.) It was collateralized by securities belonging to Bishop, securities loaned to Bishop by his wife and securities loaned to Bishop by Mather. Such collateral had an approximate market value on June 1, 1931 of $4,650,000, of which $2,250,000 was attributable to the collateral owned by Bishop and his wife. (R. 35-36.)

It is expressly stipulated and found that at the time Mather loaned his securities to Bishop and at the time the Accommodation Note was given, the circumstances and conditions were such that no gift was made or intended to be made by Mather. (R. 36, Stip. par. 4; Tax Court Findings R. 176.)

Mather died testate October 18, 1931. He owed other large obligations besides that on such Accommodation Note. His Executors made some small payment on the Accommodation Note, but as the depression continued it became obvious that the liquidation of the estate would be disastrous to both the estate and its creditors. To avoid such disastrous liquidation the Executors, legatees, creditors and Bishop and Mrs. Bishop entered into the so-called "Creditors Agreement" of November 13, 1933. (Stip. Ex. K, R. 81.)

Pursuant thereto (a) Samuel Mather Estate, Inc., an Ohio corporation (herein called the "Estate Company"), was "duly" organized; (b) all of the assets of the estate were "duly transferred" to the Estate Company; (c) the Estate Company fully assumed all of the liabilities of the estate; (d) the Executors and estate were released and discharged from such liabilities; (e) the Estate Company issued all of its common stock, Class A preferred stock and Class C preferred stock to the Executors; (f) the Estate Company then entered into a mortgage and contract with the creditors, Bishop, etc., providing among other things for an extension of time for payment of the Accommodation Note and other obligations for a period of five years from December 31, 1934; (g) a formal contract was entered into by Bishop, Mrs. Bishop and others confirming his primary obligation on the Accommodation Note and to repay with interest any amounts paid thereon by the Executors, Estate Company or successors; and (h) the Executors shortly disposed of certain shares of the Class A preferred stock to take care of certain cash bequests under Mather's will, distributed their remaining shares in the Estate Company in satisfaction of the other bequests, filed their final accounts and were discharged, and the estate was closed. (Stip. Ex. K, and Stip. pars. 10, *et seq.;* R. 81, *et seq.* and 38 *et seq.*)

The transaction between the Executors and the Estate Company was a tax-free reorganization upon which no gain or loss was recognized for federal income tax purposes. (Stip. par. 22, R. 41-42.)

By the formal contracts Bishop and his wife, in addition to confirming his primary obligation on the Accommodation Note, agreed that their securities pledged therefor should be sold first, and Mrs. Bishop also pledged, as additional security for past and future obligations of Bishop for any accommodation payments made on the note, 1,000 shares of Class C preferred stock of the Estate Company received by her on distribution from the Executors. (R. 42, 171-174.)

On the final distribution from the Executors petitioner received one-fourth of the Class C preferred stock and one-fourth of the common stock of the Estate Company, to wit: 1,000 and 250 shares, respectively. (R. 39.)

Thereafter and until 1938 the Estate Company conducted its business, disposed of assets and made payments on debts, modified its mortgage and other contracts and made certain changes in its capital structure disclosed by the record. The reality and actuality of neither its existence, its ownership of its assets, its obligations to its creditors or its corporate relations to its stockholders were ever questioned by the Commissioner; and nothing in the stipulated record throws any doubt thereon. Neither did the Commissioner question, nor does anything in the record throw any doubt upon, the actuality of the fact that shortly after the organization of the Estate Company Mather's estate was wound up and the Executors discharged.

The Estate Company was a personal holding company heavily in debt. The taxation of such companies under the Internal Revenue Laws became increasingly burdensome so that Congress included in the Revenue Act of 1938, Section 112 (b)(7) for the liquidation of such corporations without excessive tax.

It is expressly stipulated:

> "In December, 1938, said Samuel Mather Estate, Inc. was completely liquidated under and pursuant to a plan of complete liquidation *duly* adopted and carried out by it and *its shareholders* in accordance with the provisions of Section 112 (b)(7) of the Revenue Act of 1938." (Stip. par. 16, R. 40.)*

In connection with such liquidation petitioner, who still retained his Class C preferred stock and common stock, received in kind his pro rata share of the assets of the Estate Company; and,

> (a) *By formal contract with the Estate Company and its secured creditors* (including the holders of said Accommodation Note) petitioner assumed and agreed to pay *without limitation* one-fourth of the balance remaining unpaid on the Accommodation Note (which one-fourth amounted to $350,928.81) and on the other secured obligations of the Estate Company (Ex. I to Stip., R. 116, 119, par. A); and
>
> (b) *By another agreement* with the Estate Company he *also* agreed to pay one-fourth of each other debt or obligation of the Estate Company but only out of the assets distributed to him. (R. 40, 41, 114, 108.)

By September 15, 1939, all of such remaining obligation on the Accommodation Note had been fully paid,—something over $155,000 having been paid through the exhaustion of the remaining Bishop collateral and the balance being paid by petitioner from his own funds. Of the amount so paid by petitioner, something over $120,000 was paid during the year 1939. (R. 41.)

It is expressly stipulated that the Plan of Liquidation and the agreements in connection therewith were "*duly* adopted and carried out" and that the transfers of assets to

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* Emphasis throughout this petition is ours.

petitioner and the other *stockholders* in accordance therewith were "*duly*" made. (Stip. pars. 16, 18, 19, 20; R. 40.) At that time Mather's estate had been closed and his Executors had been discharged many years previous. Neither in denying the bad debt deduction claimed, nor in making the stipulations, nor before the Tax Court, *did the Commissioner ever question the reality or actuality of these stipulated transactions; and nothing in the record throws the slightest doubt thereon.*

Throughout the year 1939 Bishop was insolvent and unable to pay any amount of any unsecured obligation owed by him. (R. 36.)

In his income tax return for the year 1939, petitioner claimed as a deduction the worthless debt which thus arose and became owing to him by Bishop on account of the payments made in such year by the petitioner on the Accommodation Note. (R. 11, 12.)

The Commissioner denied such deduction. Petitioner filed a petition in the Tax Court to review such determination. In that Court the Commissioner did not question the actuality of the stipulated facts but attempted to sustain his determination principally on two grounds: (1) that Mather's was not an accommodation obligation; and (2) because, in the settlement of Mather's estate tax, an amount equal to the difference between the face amount of the Accommodation Note and the then value of the Bishop collateral had been deducted in estimating the date of death value of the net estate.

Being obviously unable to sustain the Commissioner's determination on such grounds, the Tax Court, nevertheless, did sustain such determination by finding that, under a customary administration of Mather's estate under Ohio law, his Executors would have liquidated the assets, paid the debts and distributed the net residue; that, while this was not done, the net effect on what was done was the same as if the estate had been administered in a customary

manner; that "petitioners can claim no different position than that of residuary legatees of such estate"; that petitioner was not in the position of an assignee; that his payments were purely voluntary and that no bad debt deduction would be allowed "under the circumstances." It entered an order determining a deficiency in petitioner's income tax liability for 1939 in the amount of $73,246.12.

Upon appeal, the Circuit Court affirmed the Tax Court's decision, basing its conclusion more clearly and exclusively on such application of the "rule of substance," as under the stipulated record there was, of course, no factual support for the theory that petitioner was a mere volunteer and it was conceded that a debt from Bishop to him did arise from such payments.

It is to obtain a review of such judgment of the Circuit Court of Appeals that a writ of certiorari is hereby sought.

QUESTION PRESENTED.

Is petitioner to be denied a bad debt deduction allowed by the simple, unconditional provisions of Section 23 (k) (1) of the Internal Revenue Code merely because the transaction from which the same arose was deemed by the Court below to be the substantive equivalent of some other transaction (admittedly not carried out) from which no such deduction would have arisen, although the actuality of the facts giving rise to the deduction was never questioned by the Commissioner and is fully confirmed and established by the stipulated record?

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

First: The Court below has decided a federal question in a way in conflict with the applicable decisions of this Court in *Eisner v. Macomber*, 252 U. S. 189, and *United States v. Phellis*, 257 U. S. 156, in that the Court below in regarding the "substance of the thing done" has disre-

garded the "essential truth disclosed" by the stipulated record and substituted therefor a theoretical, substantive equivalent though expressly finding that such equivalent was not "done".

Second: The decision of the Court below is in conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in *Henrietta Mills, Inc. v. Commissioner*, 52 Fed. (2d) 931, and *McDonald v. Commissioner*, 52 Fed. (2d) 920, in that the Court below, in "looking through the form" of what was done, disregarded the "essential truth disclosed" by failing to give substance and effect to the stipulated existence of a corporation and its "duly" effected acquisitions and dispositions of the property, and by substituting therefor a theoretical continuance of operations by Executors of an estate, though on the stipulated record and findings the Executors had been discharged and the estate closed by order of the probate court years before.

Third: The decision of the Court below (except for its disregard of the actualities and its creation of a fictitious substance of the "thing done") is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Shiman v. Commissioner*, 60 Fed. (2d) 65, in that it disallows the deduction of the worthless debt from Bishop to petitioner which in fact arose when petitioner paid his own money on the accommodation obligation previously undertaken in a transaction not involving any donative intent; and with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner v. Breyer* and four companion cases decided August 31, 1945 (not yet officially reported; but see C. C. H. 1945 Federal Tax Service, par. 9398) in that it treats a transferee taxpayer on a different basis from other taxpayers, although the language of the statute providing for the deduction in issue does not require or justify any different treatment.

PRAYER.

Wherefore petitioner respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Sixth Circuit requiring that Court to certify and send to this Court for its review and determination a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 9914—S. Livingston Mather, Petitioner, v. Commissioner of Internal Revenue, Respondent" and that the judgment of said Circuit Court of Appeals be reversed by this Court.

Petitioner's brief in support of his petition is annexed hereto.

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Bldg.,
Cleveland 14, Ohio,
Telephone—Main 2905,
Counsel for Petitioner.

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No. . . . . .

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Tax Court of the United States is a memorandum opinion and is not reported. It is printed at pages 175 to 184 of the Record. The opinion of the Circuit Court of Appeals is reported at 149 Fed. (2d) 393, and it is also printed at pages 199 to 205 of the Record.

JURISDICTION.

The statutes under which the jurisdiction of this Court is invoked are referred to in the petition for certiorari at page 2 above.

STATEMENT OF THE CASE.

A statement of the case is set out in the petition for certiorari (*supra,* pages 2 to 8) and will not be here repeated.

ASSIGNMENTS OF ERROR.

The Circuit Court of Appeals erred in each of the following particulars:

1. In extending the doctrine that the income tax laws are to be applied to "the substance of the thing done" in a form which applies such laws to a purely fictitious, theoretical situation flatly inconsistent with the stipulated facts, the findings of fact and the actualities of the things done.

2. In disregarding the "essential truth disclosed" by the stipulated record and the findings.

3. In failing to allow petitioner the deduction for a bad debt which he sustained and which deduction was allowable on the actual facts and substance disclosed by the record, in accordance with the simple, unconditional provisions of Section 23 (k)(1) of the Internal Revenue Code and all decisions of other Circuit Courts on the subject.

A. The Circuit Court Erred in Testing Petitioner's Right to the Deduction Claimed on the Basis of a Hypothetical Transaction (Never Carried Out) and in Disregarding the Actual Substance of the Transaction (Actually Carried Out) as Disclosed by the Stipulated Record and Findings.

This Court has repeatedly held that the Internal Revenue Laws are to be applied to the actual "substance of *the thing done*" rather than form; that the effort must be to regard *"the essential truth disclosed"*; that the "substance" to be regarded is the real actuality of the thing actually *"done,"* not a theoretical equivalent which was not "done"; and that to take the "symbol" for the "substance" violates the rule.

The leading decisions of this Court on the subject are *Eisner v. Macomber*, 252 U. S. 189, and *United States v. Phellis*, 257 U. S. 156.

In the *Eisner* case a stock dividend (involving a partial capitalization of the corporation's surplus) was held by the Commissioner to be a distribution to stockholders on the theory that, in substance, the transaction involved the pay-

ment of a cash dividend and the reinvestment of such dividend in new stock. This Court held such an assumed substance to be contrary to the actualities disclosed by the record, and not a proper application of the principle here discussed. At page 213 it said:

> "We have no doubt of the power or duty of a court to look through the form of the corporation and determine the question of the stockholder's right, in order to ascertain whether he has received income taxable by Congress without apportionment. *But, looking through the form, we cannot disregard the essential truth disclosed; ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none; and indulge the fiction that they have received and realized a share of the profits of the company which in truth they have neither received nor realized.*" *

In commenting upon a decision of the Supreme Court of Massachusetts, sustaining a state income tax on a stock dividend on the ground that the substance of the transaction was the same *as it would have been* if a cash dividend had been declared and the privilege given to subscribe for new shares, this Court further said at page 217:

> "We cannot accept this reasoning. Evidently, in order to give a sufficiently broad sweep to the new taxing provision, it was deemed necessary to take *the symbol for the substance,* accumulation for distribution, capital accretion for its opposite; * * *"

In the *Phellis* case, *supra,* a corporation transferred substantially all of its assets to a new corporation for debenture stock and then distributed such stock to its shareholders as a dividend. The Court of Claims observed that the shareholders' total holdings had not substantially changed in value and "held that the whole transaction was

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* Emphasis throughout this brief is ours.

to be regarded as merely a financial reorganization of the business of the company, producing to him (the shareholder) no profit and hence no income, and that the distribution was *in effect* a stock dividend non-taxable as income under the authority of *Eisner v. Macomber,* 252 U. S. 189 * * *."

This Court, affirming "the importance of regarding matters of substance and disregarding matters of form," overruled the decision of the Court of Claims *as an attempt to substitute for the real, actual substance a theoretical equivalent.*

The *Eisner* and *Phellis* cases were followed by the Circuit Court of Appeals for the Fourth Circuit in *McDonald v. Commissioner,* 52 Fed. (2d) 920 and *Henrietta Mills Inc.,* 52 Fed. (2d) 931.

In the former case the taxpayers had acquired the stock of a coal company at a price based on the value of its assets and the outcome of its accounts receivable and liabilities. The property of the company was subsequently sold at a price equal to the cost to the taxpayers of the stock of the company and which was in excess of the cost of the property to the company. The stockholders claimed that form should be disregarded and that the transaction should be treated as though, in substance, they had bought and sold the property. There is little question under the facts but that, the net effect was in substance as if they had done so. The Court reiterated that, "looking through the form, we cannot disregard the essential truth disclosed," and held that the corporation, having had actual existence, could not be disregarded.

The *Henrietta Mills* case, *supra,* involved a contract to buy stock of a company,—one quarter immediately at a certain price and each of the remaining three quarters in annual installments—the price of each subsequent quarter being 6% greater than that of the previous quarter. It was contended that in substance the 6% amounted to in-

terest on the deferred payment and should be so treated for tax purposes. Obviously this was the net equivalent of the transaction. However, the Court reiterated that "tax liabilities must be determined by what *in fact was done*" and held that to construe the contract as in substance requiring interest would be to make a new contract for the parties which it declined to do.

In the instant case the Circuit Court correctly stated the rule:

> "that the substance *of the thing done* and not the form it took, must govern,"

but proceeded to disregard both the form and the substance of "*the thing done,*" and to substitute therefor a purely fictitious, theoretical situation.

The Commissioner stipulated to the actuality of the following facts, and nothing in the record or findings throws any doubt thereon:

> The Estate Company was *duly* organized; its assets "duly" transferred to it and its obligations "*duly*" assumed in a tax-free transaction in which no gain or loss was recognized. The executors were "*duly*" released from the liabilities. They sold certain preferred shares of the Estate Company but distributed in kind to the legatees most of the shares of the Estate Company. They did not distribute to the legatees any of the assets or liabilities taken over by the Estate Company. Shortly after such transfers Mather's estate was wound up and the executors discharged. In December 1938 the Estate Company "duly adopted and carried out" a plan of complete liquidation in accordance with Section 112 (b) (7) of the Revenue Act of 1938 (which by the terms of that Act could have been done only by a real corporation with the concurrence by formal agreements of real stockholders). By the formal agreements in that connection there was "duly" transferred to petitioner assets of large stipulated value, and, by formal contract with the company and its creditors, he duly and without limitation as-

sumed his share of the obligation on the Accommodation Note and other secured obligations. In 1939 petitioner paid some $120,000 of his own money on the Accommodation Note and deducted as a bad debt the amount for which Bishop thereby became indebted to him. Mather's executors and estate which had long since been wound up did not make such payments and acquired no debt against Bishop.

Nevertheless, the Circuit Court affirmed the finding of the Tax Court that "the petitioners may claim no position other than that of residuary legatees" and that their right to a deduction for a bad debt was to be determined as if Mather's estate had been administered in customary manner, his debts paid by the executors and the net residue distributed by them to petitioner.

The Circuit Court's summary of the Tax Court's conclusion (R. 201, 202), which it affirmed, is printed in the margin for the convenience of the Court.*

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* "* * * The tax court assumed that the legal relationship which arose as between Mather and Bishop, was that Bishop was accommodated by Mather and that the latter had a right over against Bishop immediately upon, but not until his response under the note. It also assumed that when the note was given Bishop was solvent, and it found, as a fact, that Mather did not make a gift to Bishop as a consequence of the transaction. It concluded, however, that notwithstanding the rather elaborate and unusual method adopted and carried out in connection with the payment of Mather's debts and the distribution of his estate, *the petitioners may claim no position other than that of residuary legatees of the estate*, and do not stand in the place and stead of Mather. Their status is not analogous to that of an assignee succeeding to the rights of his assignor and subject to his liability. *Residuary legatees have no interest in a decedent's estate other than the right to receive their allotted interest* therein after the payment of all charges imposed by law and by the testator in the way of specific bequests and annuities, and that among the charges imposed by the law are the debts of the testator to which his whole estate must respond under applicable Ohio law. The duty to discharge such debts rests upon the executor. *Had Mather's estate been administered in the customary manner the petitioners would have made no payments upon the joint note, for the indebtedness would have been discharged before any rights in the estate had ripened in their behalf and before receipt of their distributive shares.*"

The Circuit Court's own conclusions (R. 203, 204) are summarized in the following:

> "The net result of the whole arrangement, realistically viewed, is that the petitioners received their interest in the Mather Estate as residuary legatees even though distribution had been postponed by an arrangement which had no purpose other than to save them from a forced liquidation in an inopportune period. The entire transaction, whatever its form, was essentially, in intent, purpose, and result, the protection of creditors and the residuary legatees in their rights respectively to the assets of the estate, and whatever may have been the transitory legal title to such assets, either in the Executors, in the corporation, or as represented by stock, the purpose of the mechanics adopted was the payment of Mather's debts and the distribution of his property to legatees under the will * * *.
>
> "That corporate ownership extended over a term of years does not deprive such ownership of its transitory character. The period of corporate life was controlled by the economic necessities of the times, and not by the unfettered will of the parties interested. It, therefore, in our judgment, is immaterial that in achieving without loss the payment of Mather's debts, in saving the interests of the legatees in the estate, such interests were, for a time, transformed from bequests to corporate stock and then from corporate stock to corporate assets. *What the petitioners received,* over and above what they paid out, *were legacies provided by the will of Mather* and *it is unimportant whether Mather's debts were paid by the executors, the corporation, or the legatees.* * * *"

All this in spite of the fact that the Court said (R. p. 202):

> "The petitioners, however, insist, and *the tax court concedes,* that Mather's estate was *not* so administered; that the manner of administration was forced upon them by urgent financial and business necessities; was adopted in good faith without tax-dodging

purpose, and *that the deductions claimed are precisely those which would have been allowed to Mather if he had lived, or to the estate if it had continued to administer.*"

Thus, in one breath it is conceded that Mather's estate was not administered in customary manner and in the next it is said that all of the stipulated realities are to be disregarded and petitioner taxed "as if" Mather's estate had been administered in customary manner.

From 1934 on the executors, the probate court, the Estate Company, its creditors and its stockholders, the Commissioner of Internal Revenue and all other parties concerned, dealt with the stipulated actualities as actualities. Based on such actualities large amounts of property were held and transferred; debts were paid; the corporation and stockholders made tax returns, the executors made their final tax returns and were discharged; the statutory corporate liquidation was "duly" carried out with the necessary agreements of the stockholders (as corporate stockholders) with reference to the tax consequences thereof. (See Section 112 (b)(7) and the Commissioner's regulations thereunder; CCH 1939 Federal Tax Service, pars. 734B to 734I, inclusive.)

If the real substance and actuality of these transactions was that the executors liquidated the estate and distributed the net assets to the legatees, what is to happen to all of the executors', the Estate Company's and the stockholders' tax returns for these five years?

If the real "substance of the thing done" was, for the purpose of now governing the stockholders' tax returns, a customary administration of Mather's estate, then that must have been the real substance of the thing done for the purposes of the tax returns of the executors and the Estate Company and for the stockholders in connection with the liquidation under Section 112 (b)(7). No such liquidation occurred. The stockholders' agreements under

that statute are fictitious,—as is the Commissioner's stipulation.

"Substance" is the real, legal and practical actuality of "*the thing done.*" It is not (under this Court's decisions) what the Commissioner, the Tax Court or a reviewing Court may determine to be *a substantive equivalent of what was done.*

If the rule is now to be changed from "*the substance of the thing done*" to what the Commissioner or a court may determine to be a *substantive equivalent of the thing done,* then endless confusion and uncertainty will be injected into the administration of the tax laws. In almost every business transaction the general purpose and result sought can be legally and properly accomplished in a variety of ways. A trust, partnership or syndicate can often be substituted for a corporation or vice versa. All of a corporation's assets can be purchased or its stock can be purchased. Estates can be liquidated into net cash or assets can be distributed in kind, with or without full satisfaction of the estate's obligations depending upon creditor's consent.

If, after a definite, legal and proper procedure (not a sham procedure or one adopted for tax dodging purposes) is decided upon and "duly carried out" by a taxpayer, and the Commissioner so stipulates, we must still await the varied determinations of the Tax Court and a reviewing Court as to what taxpayer might have done to accomplish the same purpose and result (the substantive equivalent of what he did do), the variations and uncertainties in tax results will be limited only by the scope of the imaginations of the judges who consider the matter.

We submit that this Court, when it adopted the rule of "substance versus form," intended to sanction no such result.

We also submit that the decision of the Circuit Court (holding as it does that the "substance of the thing done"

"was essentially" the payment of the debts of the estate by the Executors and the distribution of the net proceeds to "the residuary legatees" as "legacies provided by the will of Mather" when, under the stipulated actualities, the Executors did not do so, and petitioner alone made the payment on the Accommodation Note and acquired the debt against Bishop here in issue), is in conflict with the decisions of this Court in the *Eisner* and *Phellis* cases, *supra,* and should be reversed.

The Circuit Court's disregard of the stipulated actualities is also in direct conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in the *McDonald* case, *supra,* and in the *Henrietta Mills* case, *supra*—its disregard of the stipulated existence and "duly" effected transactions of the Estate Company being in particularly direct and irreconcilable conflict with the decision in the *McDonald* case.

B. On the Stipulated Record (Disregarding the Fictitious Substance Created by the Courts Below) Their Decision is in Conflict with Established Law and Decisions of Other Circuits.

Section 23 (k)(1) of the Internal Revenue Code allows, in simple unconditional form, to all taxpayers, deduction for worthless debts. The deduction is not limited to particular classes of taxpayers, nor to business or other particular kinds of debts. (5 *Mertens Law of Federal Income Taxation,* 1942 (Sec. 30:01).)

The basic problem "is to determine whether the taxpayer is owed a debt" or whether the transaction involved a gift or a voluntary payment under which no debt to him arose. *Mertens,* Sec. 30:01; Sec. 30:04.

> "If there is a debt in fact and in law, the taxpayer will not be denied the deduction because the loan is not a 'wise' loan."
>
> *Mertens,* Sec. 30:10.

The undertaking of an accommodation obligation as maker or endorser gives rise to no debt from the accommodated party, but such debt does arise when, but not until, the accommodation party makes payment on the accommodation debt.

Bendey v. Townsend, 109 U. S. 665 (1883);
Wheeler v. Young, 193 Mass. 143 (1886);
Runkle v. Pullen, 49 Indiana Appeals 616 (1912);
Grygiel v. Maroille, 51 R. I. 109 (1930).

The same is also the law where the payment is made by the successor in liability to the accommodation party.

Burton v. Slaughter, 67 Va. 914 (1875);
Nelson v. Close, 147 Md. 214 (1925).

In the instant case it cannot be, and is not, questioned that a debt from Bishop to petitioner arose when petitioner, in 1939, made the stipulated payments on the accommodation debt. That such a debt did so arise in fact and in law is demonstrated (a) by the foreging principles which caused it to arise as a matter of law, it being expressly stipulated that "no gift was made or intended"; (b) by the formal contract with Bishop confirming his primary liability and his agreement to repay with interest any amounts paid on the accommodation obligation by the Estate Company or its successors; and (c) by the concessions of the Tax Court, confirmed by the Circuit Court,

> "that the deductions claimed are precisely those which would have been allowed to Mather if he had lived, or to the Estate if it had continued to administer." (R. 202.)

And by the Circuit Court's finding:

> "The petitioners contend that Mather was simply an accommodation maker of the joint note executed by himself and Bishop; that as such he had an inchoate right to recover from Bishop any amount which he might be required to pay thereon; that the petitioners

> succeeded to that right; that it was brought to fruition by the payments made by them in 1939; and that Bishop being then insolvent, they became, immediately upon payment, entitled to a bad debt deduction. *As to the steps in this rationalization, short of its final conclusion, there is no controversy.*" (R. 201.)

The Circuit Court of Appeals for the Second Circuit, in *Shiman v. Commissioner*, 60 Fed. (2d) 65 (1932), held that the right of an accommodation party to take deduction for the debt due him which arises when he makes payment upon an accommodation obligation, is in no way destroyed or restricted by the fact that the debt may be worthless when it arises.

In the thirteen years that have elapsed since the decision in the *Shiman* case, *supra*, the rule there laid down has been consistently applied by the Board of Tax Appeals and by other Federal Courts.

That a transferee taxpayer, who has assumed an obligation, is not to be taxed with respect thereto on a different basis from other taxpayers where the statute providing for the deduction in issue does not provide for any different treatment of a transferee, is now expressly confirmed by the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner v. Breyer* and companion cases, *supra*.

In the instant case the Circuit Court made a collateral attempt to distinguish the *Shiman* case on the ground that petitioners were not in Mather's position because their assumption of the accommodation debt

> "was tied to and limited by their distributable share in corporation assets, and such assets were the actual or converted assets of the Mather estate and none other." (R. 203.)

To the extent that this involves the fictitious assumption that Mather's estate paid the Accommodation Note and distributed the net assets, it is discussed under "A" above.

To the extent that it might otherwise indicate a finding that petitioner's assumption of the accommodation obligations in connection with the 1938 liquidation of the Estate Company was so limited, it is flatly contrary to the stipulated record and supported by nothing in the record.

It is stipulated that the Estate Company "was completely liquidated under and pursuant to a Plan of Complete Liquidation duly adopted and carried out * * *." (R. 40.) *Section 1* of that Plan (R. 114) expressly provided for the execution and delivery of a necessary Amendment to the Mortgage Trust Indenture, which secured the payment of the Accommodation Note and other notes of the Estate Company, by the Company's common stockholders (including the petitioner). (Ex. I to Plan, R. 116.)

Section A of that Amendment (R. 118) provided—

> "Each of the parties of the Third Part (petitioner and others) hereby assumes and agrees, for the benefit of the holder of each note secured by said Indenture, to pay that proportion of each debt and obligation of the Corporation represented by each note secured by said Indenture, or under or arising from said Indenture as hereby supplemented and amended, as the number of common shares of the Corporation held by him is to the total number of the common shares of the Corporation as set forth in Recital 2 hereof." *

It is thus clear that petitioner's assumed liability with respect to the Accommodation Note was in no way qualified, or limited to his distributive share of the assets of the Estate Company. He had to pay what Bishop didn't, even if it took every asset he owned.

If the Court below intended to go beyond its fictitious reconstruction of "the thing done," it is possible that it was misled by *Section 4* of the Plan of Liquidation (R. 114) in which it was *also* provided that each common stock-

---

* There were 1,000 shares of such common stock outstanding, of which 250 were held by petitioner. (R. 117.)

holder should assume and agree to pay, "but only out of assets distributed to him," his proportion of *every* debt or obligation of the Estate Company. This was, of course, a limited assumption of the Company's *general liabilities. Its existence, however, could not and did not in any way, in fact or in law, impair or limit the full, personal, unconditional and unlimited assumption of the Accommodation* and other secured note obligations undertaken by petitioner *through his execution* with the Company and *its creditors* (in accordance with Section 1 of the Plan) of the Amendment to the Mortgage Trust Indenture as above recited.

It is thus clear that neither reason given by the Circuit Court for departing from the established rule of the *Shiman* case finds support in fact, form or substance of the thing done.

The basic provision of Section 23 (k)(1) for the allowance to all taxpayers of deductions for worthless debts has stood in the Internal Revenue Code without material amendment for many years. It has been applied to all taxpayers without distinction and subject only to the basic test,—Was there in fact and in law a debt owed to taxpayer and did it become worthless? In re-enacting such provision of the Code, Congress has re-affirmed such interpretation.

Similarly, the basic rule laid down by this Court in the *Eisner* and *Phellis* cases, that the Internal Revenue Laws are to be applied to the actual, existing substance of *"the thing done,"* has been accepted by Congress by its repassage of the Internal Revenue Laws without change in this regard.

The decision of the Court below in the instant case either (1) throws unlimited confusion into the interpretation and application of this rule of substance, or (2) it creates equal confusion and uncertainty as to the meaning and application of the simple provision of Section 23 (k)(1).

Actually, as the decision stands, it is clearly and directly in conflict with the decisions of this Court and with those of other Circuit Courts on the rule of substance; and, unless that conflict is resolved in favor of the Court below, then its interpretation and application of Section 23 (k)(1) is in conflict with all previous decisions on the subject.

Various cases cited by the Court below as authority for its position are discussed in the appendix.

CONCLUSION.

Because the decision of the Circuit Court in the instant case is in conflict with the decisions of other Circuit Courts, and because the Circuit Court has decided a federal question in a way in conflict with the applicable decisions of this Court, petitioner requests that his petition for a writ of certiorari be granted.

Respectfully submitted,

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Bldg.,
Cleveland 14, Ohio,
Telephone—Main 2905,
Counsel for Petitioner.

APPENDIX.

Cases Relied on by Circuit Court to Defeat Petitioner's Claim to a Bad-Debt Deduction.

Tulsa Tribune Co. v. Commissioner, 58 Fed. (2d) 937.

In this case three men agreed to organize a corporation and furnish it the necessary capital to buy a Tulsa newspaper. One of the promoters negotiated the purchase with funds in part advanced by the three and in part borrowed for the purpose. The corporation was then organized, took the property, and issued its stock for the money advanced by the promoters and assumed their debt for the money borrowed. The Court held (citing numerous cases) that, in so acting, the three promoters were in law and in fact the agents of the new company so that, upon its organization, their acts became the acts of the new company, and that the corporation had, therefore, paid cash for the property and issued its stock to the subscribers for the money advanced by them for its account.

This was not a holding that, if three individuals owned property and contributed it to a corporation for its stock, the transaction might be held in "substance" to have been that they paid cash for the stock and the company paid them cash for the property because the net result in substance would have been similar.

To make the situation in the case at bar analogous to that involved in the *Tulsa Tribune Co.* case, it would have been necessary for the Courts below to have found that Samuel Mather Estate, Inc. took the assets and liabilities from the Mather executors as their agent; that its stockholders took the same in 1938 and made their payments in 1939 as agents of the executors; and that then the executors and Probate Court distributed the net assets to the legatees under Mather's will,—although under the stipulated actualities all of the transfers were "duly" made; the statutory corporate liquidation was "duly carried out"; the execu-

tors were discharged; the legatees had accepted shares of the Estate Company in full satisfaction of their claims against the Estate and some of them had disposed of all or part of their stock in the Estate Company; and everything in the record indicated that the Estate Company had been organized to hold the assets in perpetuity and only liquidated because of the difficulties which later developed and for the relief of which Congress included in the 1938 Revenue Act the special liquidation provisions of Section 112(b)(7).

Commissioner v. Ashland Oil & Refining Co., 99 Fed. (2) 588;
Prairie Oil & Gas Co. v. Motter, 66 Fed. (2d) 309.

In each of these cases a company desired to acquire *certain* assets of another corporation. The transferor corporation was therefore stripped of its other assets and the stock of the transferor was assigned to the transferee upon payment in cash of the price agreed to be paid for the property. The transferor was thereupon immediately liquidated and its assets transferred to the acquiring company. It was held in each case that the transaction was not a tax-free reorganization and that the tax base of the acquired assets in the hands of the purchasing company was the price it paid for the stock. While the opinions contain some interesting discussion of the rule of real "substance," they are in no way authority for disregarding real, actual, functioning, corporate entities, or for substituting the "substance of what might have been done" for the "substance *of the thing done.*"

To make those decisions applicable to the Mather situation, it would have been necessary for the Tax and Circuit Courts to have found that Mather's estate was administered in the customary manner (when in fact it is conceded by both Courts that such is not the case), and that Samuel Mather Estate, Inc. was only a sham and a fiction

and it and its stockholders were only an agency of the executors and the Probate Court and that such executors and court were in fact directing and conducting the Company's business and the actions and payments of its stockholders for years after the estate was closed.

Ahles Realty Corporation v. Commissioner, 71 Fed. (2d) 150.

In this case a corporation, all of whose stock was owned by one Snyder as trustee, transferred all of its assets to petitioner in exchange for all of petitioner's stock and income debenture bonds. The transferor corporation was subsequently liquidated and the securities of the petitioner ultimately passed to Snyder. Upon the subsequent sale by the petitioner of the property so acquired, the Commissioner took the position that the basis for determining gain or loss realized upon the sale was the cost of the property to the transferor corporation, while petitioner contended that such basis was the fair market value of the property at the date of acquisition. The Court held that the transaction was in substance a reorganization of the transferor corporation and not in truth or in fact a sale of the property involved.

Here again neither the holding, nor the language of the opinion, enlarges the rule of "substance of *the thing done*" to include, as *done,* things found not to have been *done.*

Helvering v. Clifford, 309 U. S. 331.

Here a husband had declared himself trustee for five years of certain of his own securities to pay the income to his wife during such period. The Supreme Court held that he "continued to be the owner" of the securities, that he "retained the substance of full enjoyment of all the rights which previously he had in the property" and that it was not reversible error for the trial court to find that

"the husband was the owner of the corpus." Being the owner, he, and not the trust, was accordingly taxed on the income.

This was *not* a holding that, although the husband was not the owner, he was to be taxed on the income as if he had been the owner.

To make the instant case fit such holding, it would have been necessary for the Tax and Circuit Courts to have found that the executors continued to own the Mather assets throughout the life of the Estate Company and while they were in the hands of, and the income from them was being taxed to, the stockholders; that the stipulated statutory corporate liquidation did not occur; and that the executors and not petitioner, in substance and in fact, made the 1939 payments on the accommodation note from funds of the closed estate.

The Tax and Circuit Courts did not so find. They found in substance and in fact just the opposite. But both Courts held that petitioner should nevertheless be taxed as if they had so found.

FILED
SEP 28 1945

In the Supreme Court of the United States

OCTOBER TERM, 1945.

No. 456

TESTAMENTARY TRUST u/w OF SAMUEL MATHER,
Deceased,
William G. Mather and S. Livingston Mather,
Trustees,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit
and
BRIEF OF PETITIONER.

JOHN B. PUTNAM,
EDWIN A. HOWE,
Union Commerce Building, Cleveland, Ohio,
Counsel for Petitioner.

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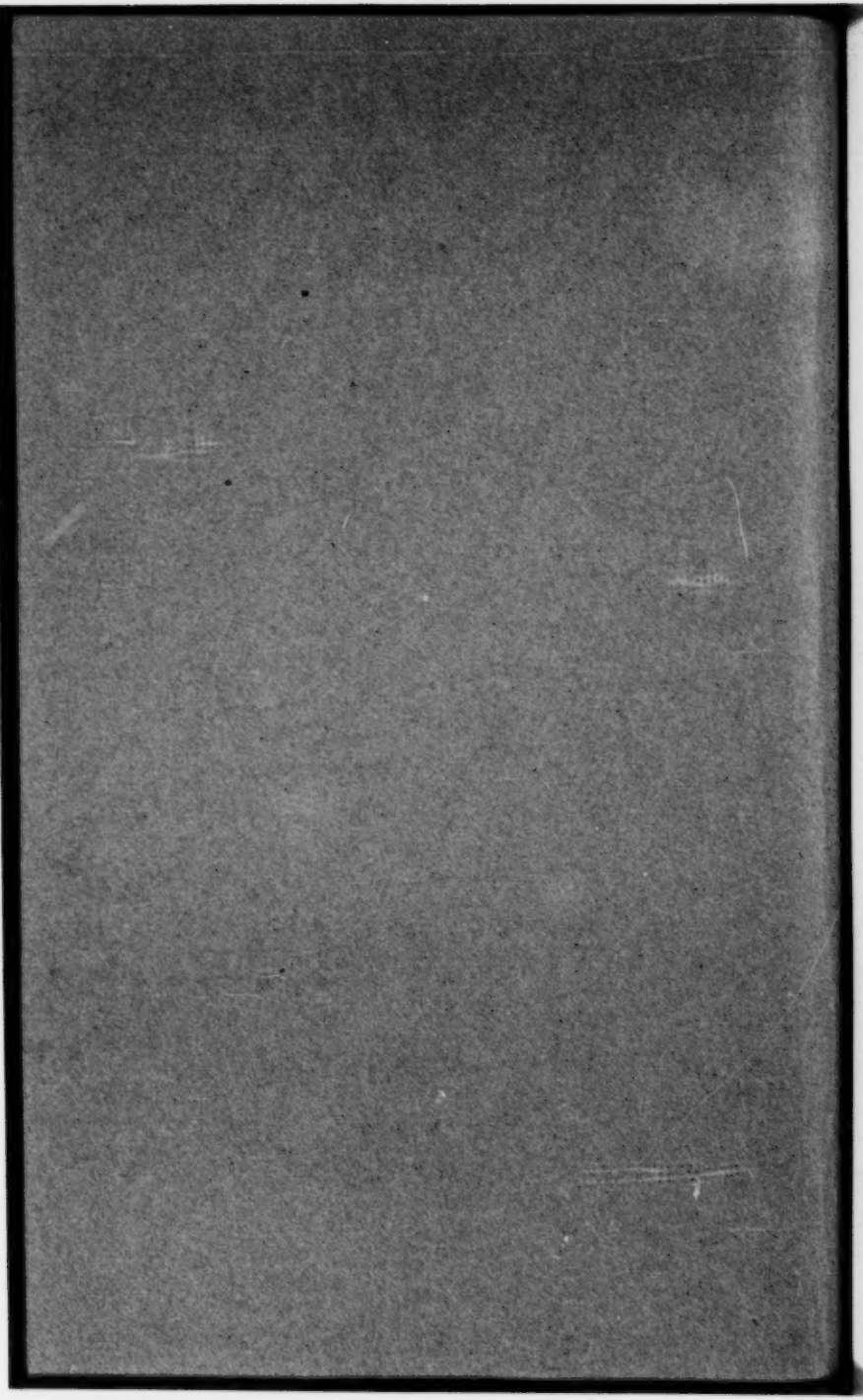

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In the Supreme Court of the United States

OCTOBER TERM, 1945.

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TESTAMENTARY TRUST u/w OF SAMUEL MATHER,
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William G. Mather and S. Livingston Mather,
Trustees,*
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to review the judgments of the Circuit Court of Appeals for the Sixth Circuit entered in this case on May 23, 1945 and July 2, 1945, respectively. Said judgment entered on May 23, 1945, affirmed the judgment of the Tax Court of the United States in favor of respondent and against petitioner relating to petitioner's federal income tax liability for the year 1939. Said judgment entered on July 2, 1945, denied petitioner's petition for rehearing and reargument of this case.

* This case involves substantially the same facts and the same issues as those involved in S. Livingston Mather v. Commissioner in which a petition for a writ is being concurrently filed.

JURISDICTION OF THE COURT.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; U. S. C., Title 28, Section 347 a) and Section 1141 of the Internal Revenue Code (53 Stat. 154; U. S. C., Title 26, Section 1141).

STATUTE INVOLVED.

The statute involved is Section 23 (k)(1) of the Internal Revenue Code, the relevant part of which reads as follows:

> "Sec. 23. In computing net income, there shall be allowed as deductions:
>
> * * * * *
>
> (k) Bad Debts.—
>
> (1) General Rule.—Debts which become worthless within the taxable year; * * *"

STATEMENT OF THE MATTER INVOLVED.

The facts are all stipulated. They show, and it is conceded, that during 1939 petitioner paid from its own funds approximately $49,000 on its accommodation obligation on a promissory note to Cleveland banks on which Robert H. Bishop, Jr., was the primary obligor; that a debt from Bishop to petitioner arose from such payments; that at the time the accommodation obligation was undertaken "no gift was made or intended"; that during 1939 Bishop was insolvent and unable to pay anything on any unsecured obligation; and that petitioner took a deduction in its income tax return for 1939 for the debt from Bishop to it which thus arose and became worthless in that year.

Petitioner's apparent right (under the provisions of Section 23 (k)(1) above quoted) to a deduction for such worthless debt was, however, denied by the Tax Court and the Circuit Court because they said that the stipulated

facts were the substantive equivalent of a theoretical situation under which petitioner would not itself have made such payments or acquired such debt and that petitioner's right to such deduction must be controlled by such theoretical substantive equivalent of the stipulated facts.

The following background facts, which were stipulated without question as to their actuality, are also involved in the issue:

Petitioner is a testamentary trust created under the will of Samuel Mather, deceased (herein called "Mather") for the benefit of his granddaughter. Prior to June 1, 1931, Robert H. Bishop, Jr. (herein called "Bishop"), Mather's son-in-law, maintained certain brokerage accounts. During the period from September 29, 1930 to April 14, 1931, Mather loaned Bishop various securities which were used by Bishop to collateralize his indebtedness under such accounts. (R. 43-45.)

On June 1, 1931, Mather, for the accommodation of Bishop, joined with Bishop in executing and delivering to The Guardian Trust Company of Cleveland, Ohio, a note (herein referred to as the "Accommodation Note") in the principal sum of $3,566,000. The entire proceeds of this note were disbursed by The Guardian Trust Company in payment of Bishop's indebtednesses. (R. 43-45.) It was collateralized by securities belonging to Bishop, securities loaned to Bishop by his wife and securities loaned to Bishop by Mather. Such collateral had an approximate market value on June 1, 1931 of $4,650,000, of which $2,250,000 was attributable to the collateral owned by Bishop and his wife. (R. 46.)

It is expressly stipulated and found that at the time Mather loaned his securities to Bishop and at the time the Accommodation Note was given, the circumstances and conditions were such that no gift was made or intended to be made by Mather. (R. 46, 47, Stip. par. 4; Tax Court Findings R. 176.)

Mather died testate October 18, 1931. He owed other large obligations besides that on such Accommodation Note. His Executors made some small payment on the Accommodation Note, but as the depression continued it became obvious that the liquidation of the estate would be disastrous to both the estate and its creditors. To avoid such disastrous liquidation the Executors, legatees, creditors and Bishop and Mrs. Bishop entered into the so-called "Creditors Agreement" of November 13, 1933. (Stip. Ex. K, R. 81.)

Pursuant thereto (a) Samuel Mather Estate, Inc., an Ohio corporation (herein called the "Estate Company"), was "duly" organized; (b) all of the assets of the estate were "duly transferred" to the Estate Company; (c) the Estate Company fully assumed all of the liabilities of the estate; (d) the Executors and estate were released and discharged from such liabilities; (e) the Estate Company issued all of its common stock, Class A preferred stock and Class C preferred stock to the Executors; (f) the Estate Company then entered into a mortgage and contract with the creditors, Bishop, etc., providing among other things for an extension of time for payment of the Accommodation Note and other obligations for a period of five years from December 31, 1934; (g) a formal contract was entered into by Bishop, Mrs. Bishop and others confirming his primary obligation on the Accommodation Note and to repay with interest any amounts paid thereon by the Executors, Estate Company or successors; and (h) the Executors shortly disposed of certain shares of the Class A preferred stock to take care of certain cash bequests under Mather's will, distributed their remaining shares in the Estate Company in satisfaction of the other bequests, filed their final accounts and were discharged, and the estate was closed. (Stip. Ex. K, and Stip. pars. 10, *et seq.;* R. 81, *et seq.* and 49 *et seq.*)

The transaction between the Executors and the Estate Company was a tax-free reorganization upon which no gain or loss was recognized for federal income tax purposes. (Stip. par. 22, R. 52.)

By the formal contracts Bishop and his wife, in addition to confirming his primary obligation on the Accommodation Note, agreed that their securities pledged therefor should be sold first, and Mrs. Bishop also pledged, as additional security for past and future obligations of Bishop for any accommodation payments made on the note, 1,000 shares of Class C preferred stock of the Estate Company received by her on distribution from the Executors. (R. 52, 171-174.)

On the final distribution from the Executors petitioner received one-sixteenth of the Class C preferred stock and one-sixteenth of the common stock of the Estate Company, to wit: 250 and 62½ shares, respectively. (R. 50, 51.)

Thereafter and until 1938 the Estate Company conducted its business, disposed of assets and made payments on debts, modified its mortgage and other contracts and made certain changes in its capital structure disclosed by the record. The reality and actuality of neither its existence, its ownership of its assets, its obligations to its creditors or its corporate relations to its stockholders were ever questioned by the Commissioner; and nothing in the stipulated record throws any doubt thereon. Neither did the Commissioner question, nor does anything in the record throw any doubt upon, the actuality of the fact that shortly after the organization of the Estate Company Mather's estate was wound up and the Executors discharged.

The Estate Company was a personal holding company heavily in debt. The taxation of such companies under the Internal Revenue Laws became increasingly burdensome so that Congress included in the Revenue Act of 1938, Section 112 (b)(7) for the liquidation of such corporations without excessive tax.

It is expressly stipulated:

> "In December, 1938, said Samuel Mather Estate, Inc. was completely liquidated under and pursuant to a plan of complete liquidation *duly* adopted and carried out by it and *its shareholders* in accordance with the provisions of Section 112 (b)(7) of the Revenue Act of 1938." (Stip. par. 16, R. 50.)*

In connection with such liquidation petitioner, which still retained its Class C preferred stock and common stock, received in kind its pro rata share of the assets of the Estate Company; and,

> (a) *By formal contract with the Estate Company and its secured creditors* (including the holders of said Accommodation Note) petitioner assumed and agreed to pay *without limitation* one-sixteenth of the balance remaining unpaid on the Accommodation Note (which one-sixteenth amounted to $87,732.19) and on the other secured obligations of the Estate Company (Ex. I to Stip., R. 116, 119, par. A); and
>
> (b) *By another agreement* with the Estate Company it *also* agreed to pay one-sixteenth of each other debt or obligation of the Estate Company but only out of the assets distributed to it. (R. 51, 52, 114, 108.)

By September 15, 1939, all of such remaining obligation on the Accommodation Note had been fully paid,—something over $38,000 having been paid through the exhaustion of the remaining Bishop collateral and the balance (approximately $49,000) being paid by petitioner from its own funds during the year 1939. (R. 52.)

It is expressly stipulated that the Plan of Liquidation and the agreements in connection therewith were "*duly* adopted and carried out" and that the transfers of assets to petitioner and the other *stockholders* in accordance therewith were "*duly*" made. (Stip. pars. 16, 18, 19, 20; R. 50-52.)

---

* Emphasis throughout this petition is ours.

At that time Mather's estate had been closed and his Executors had been discharged many years previous. Neither in denying the bad debt deduction claimed, nor in making the stipulations, nor before the Tax Court, *did the Commissioner ever question the reality or actuality of these stipulated transactions; and nothing in the record throws the slightest doubt thereon.*

Throughout the year 1939 Bishop was insolvent and unable to pay any amount of any unsecured obligation owed by him. (R. 47.)

In its income tax return for the year 1939, petitioner claimed as a deduction the worthless debt which thus arose and became owing to it by Bishop on account of the payments made in such year by the petitioner on the Accommodation Note. (R. 22.)

The Commissioner denied such deduction. Petitioner filed a petition in the Tax Court to review such determination. In that Court the Commissioner did not question the actuality of the stipulated facts but attempted to sustain his determination principally on two grounds: (1) that Mather's was not an accommodation obligation; and (2) because, in the settlement of Mather's estate tax, an amount equal to the difference between the face amount of the Accommodation Note and the then value of the Bishop collateral had been deducted in estimating the date of death value of the net estate.

Being obviously unable to sustain the Commissioner's determination on such grounds, the Tax Court, nevertheless, did sustain such determination by finding that, under a customary administration of Mather's estate under Ohio law, his Executors would have liquidated the assets, paid the debts and distributed the net residue; that, while this was not done, the net effect on what was done was the same as if the estate had been administered in a customary manner; that "petitioners can claim no different position than that of residuary legatees of such estate"; that peti-

tioner was not in the position of an assignee; that its payments were purely voluntary and that no bad debt deduction would be allowed "under the circumstances." It entered an order determining a deficiency in petitioner's income tax liability for 1939 in the amount of $6,466.67.

Upon appeal, the Circuit Court affirmed the Tax Court's decision, basing its conclusion more clearly and exclusively on such application of the "rule of substance," as under the stipulated record there was, of course, no factual support for the theory that petitioner was a mere volunteer and it was conceded that a debt from Bishop to it did arise from such payments.

It is to obtain a review of such judgment of the Circuit Court of Appeals that a writ of certiorari is hereby sought.

QUESTION PRESENTED.

Is petitioner to be denied a bad debt deduction allowed by the simple, unconditional provisions of Section 23 (k) (1) of the Internal Revenue Code merely because the transaction from which the same arose was deemed by the Court below to be the substantive equivalent of some other transaction (admittedly not carried out) from which no such deduction would have arisen, although the actuality of the facts giving rise to the deduction was never questioned by the Commissioner and is fully confirmed and established by the stipulated record?

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

First: The Court below has decided a federal question in a way in conflict with the applicable decisions of this Court in *Eisner v. Macomber*, 252 U. S. 189, and *United States v. Phellis*, 257 U. S. 156, in that the Court below in regarding the "substance of the thing done" has disregarded the "essential truth disclosed" by the stipulated record and substituted therefor a theoretical, substantive

equivalent though expressly finding that such equivalent was not "done".

Second: The decision of the Court below is in conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in *Henrietta Mills, Inc. v. Commissioner*, 52 Fed. (2d) 931, and *McDonald v. Commissioner*, 52 Fed. (2d) 920, in that the Court below, in "looking through the form" of what was done, disregarded the "essential truth disclosed" by failing to give substance and effect to the stipulated existence of a corporation and its "duly" effected acquisitions and dispositions of the property, and by substituting therefor a theoretical continuance of operations by Executors of an estate, though on the stipulated record and findings the Executors had been discharged and the estate closed by order of the probate court years before.

Third: The decision of the Court below (except for its disregard of the actualities and its creation of a fictitious substance of the "thing done") is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Shiman v. Commissioner*, 60 Fed. (2d) 65, in that it disallows the deduction of the worthless debt from Bishop to petitioner which in fact arose when petitioner paid its own money on the accommodation obligation previously undertaken in a transaction not involving any donative intent; and with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner v. Breyer* and four companion cases decided August 31, 1945 (not yet officially reported; but see C. C. H. 1945 Federal Tax Service, par. 9398) in that it treats a transferee taxpayer on a different basis from other taxpayers, although the language of the statute providing for the deduction in issue does not require or justify any different treatment.

PRAYER.

Wherefore petitioner respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Sixth Circuit requiring that Court to certify and send to this Court for its review and determination a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 9915—Testamentary Trust u/w of Samual Mather, Deceased, William G. Mather and S. Livingston Mather, Trustees, Petitioner, v. Commissioner of Internal Revenue, Respondent" and that the judgment of said Circuit Court of Appeals be reversed by this Court.

Petitioner's brief in support of its petition is annexed hereto.

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Bldg.,
Cleveland 14, Ohio,
Telephone—Main 2905,
Counsel for Petitioner.

In the Supreme Court of the United States

OCTOBER TERM, 1945.

No. . . . . .

TESTAMENTARY TRUST u/w OF SAMUEL MATHER,
Deceased,
William G. Mather and S. Livingston Mather,
Trustees,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Tax Court of the United States is a memorandum opinion and is not reported. It is printed at pages 175 to 184 of the Record. The opinion of the Circuit Court of Appeals is reported at 149 Fed. (2d) 393, and it is also printed at pages 199 to 205 of the Record.

JURISDICTION.

The statutes under which the jurisdiction of this Court is invoked are referred to in the petition for certiorari at page 2 above.

STATEMENT OF THE CASE.

A statement of the case is set out in the petition for certiorari (*supra*, pages 2 to 8) and will not be here repeated.

ASSIGNMENTS OF ERROR.

The Circuit Court of Appeals erred in each of the following particulars:

1. In extending the doctrine that the income tax laws are to be applied to "the substance of the thing done" in a form which applies such laws to a purely fictitious, theoretical situation flatly inconsistent with the stipulated facts, the findings of fact and the actualities of the things done.

2. In disregarding the "essential truth disclosed" by the stipulated record and the findings.

3. In failing to allow petitioner the deduction for a bad debt which it sustained and which deduction was allowable on the actual facts and substance disclosed by the record, in accordance with the simple, unconditional provisions of Section 23 (k)(1) of the Internal Revenue Code and all decisions of other Circuit Courts on the subject.

A. The Circuit Court Erred in Testing Petitioner's Right to the Deduction Claimed on the Basis of a Hypothetical Transaction (Never Carried Out) and in Disregarding the Actual Substance of the Transaction (Actually Carried Out) as Disclosed by the Stipulated Record and Findings.

This Court has repeatedly held that the Internal Revenue Laws are to be applied to the actual "substance of *the thing done*" rather than form; that the effort must be to regard "*the essential truth disclosed*"; that the "substance" to be regarded is the real actuality of the thing actually "*done,*" not a theoretical equivalent which was not "done"; and that to take the "symbol" for the "substance" violates the rule.

The leading decisions of this Court on the subject are *Eisner v. Macomber,* 252 U. S. 189, and *United States v. Phellis,* 257 U. S. 156.

In the *Eisner* case a stock dividend (involving a partial capitalization of the corporation's surplus) was held by the Commissioner to be a distribution to stockholders on the theory that, in substance, the transaction involved the pay-

ment of a cash dividend and the reinvestment of such dividend in new stock. This Court held such an assumed substance to be contrary to the actualities disclosed by the record, and not a proper application of the principle here discussed. At page 213 it said:

> "We have no doubt of the power or duty of a court to look through the form of the corporation and determine the question of the stockholder's right, in order to ascertain whether he has received income taxable by Congress without apportionment. *But, looking through the form, we cannot disregard the essential truth disclosed; ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none; and indulge the fiction that they have received and realized a share of the profits of the company which in truth they have neither received nor realized.*" *

In commenting upon a decision of the Supreme Court of Massachusetts, sustaining a state income tax on a stock dividend on the ground that the substance of the transaction was the same *as it would have been* if a cash dividend had been declared and the privilege given to subscribe for new shares, this Court further said at page 217:

> "We cannot accept this reasoning. Evidently, in order to give a sufficiently broad sweep to the new taxing provision, it was deemed necessary to take *the symbol for the substance*, accumulation for distribution, capital accretion for its opposite; * * *"

In the *Phellis* case, *supra*, a corporation transferred substantially all of its assets to a new corporation for debenture stock and then distributed such stock to its shareholders as a dividend. The Court of Claims observed that the shareholders' total holdings had not substantially changed in value and "held that the whole transaction was

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* Emphasis throughout this brief is ours.

to be regarded as merely a financial reorganization of the business of the company, producing to him (the shareholder) no profit and hence no income, and that the distribution was *in effect* a stock dividend non-taxable as income under the authority of *Eisner v. Macomber,* 252 U. S. 189 * * *."

This Court, affirming "the importance of regarding matters of substance and disregarding matters of form," overruled the decision of the Court of Claims *as an attempt to substitute for the real, actual substance a theoretical equivalent.*

The *Eisner* and *Phellis* cases were followed by the Circuit Court of Appeals for the Fourth Circuit in *McDonald v. Commissioner,* 52 Fed. (2d) 920 and *Henrietta Mills Inc.,* 52 Fed. (2d) 931.

In the former case the taxpayers had acquired the stock of a coal company at a price based on the value of its assets and the outcome of its accounts receivable and liabilities. The property of the company was subsequently sold at a price equal to the cost to the taxpayers of the stock of the company and which was in excess of the cost of the property to the company. The stockholders claimed that form should be disregarded and that the transaction should be treated as though, in substance, they had bought and sold the property. There is little question under the facts but that, the net effect was in substance as if they had done so. The Court reiterated that, "looking through the form, we cannot disregard the essential truth disclosed," and held that the corporation, having had actual existence, could not be disregarded.

The *Henrietta Mills* case, *supra,* involved a contract to buy stock of a company,—one quarter immediately at a certain price and each of the remaining three quarters in annual installments—the price of each subsequent quarter being 6% greater than that of the previous quarter. It was contended that in substance the 6% amounted to in-

terest on the deferred payment and should be so treated for tax purposes. Obviously this was the net equivalent of the transaction. However, the Court reiterated that "tax liabilities must be determined by what *in fact was done*" and held that to construe the contract as in substance requiring interest would be to make a new contract for the parties which it declined to do.

In the instant case the Circuit Court correctly stated the rule:

> "that the substance *of the thing done* and not the form it took, must govern,"

but proceeded to disregard both the form and the substance of *"the thing done,"* and to substitute therefor a purely fictitious, theoretical situation.

The Commissioner stipulated to the actuality of the following facts, and nothing in the record or findings throws any doubt thereon:

> The Estate Company was *duly* organized; its assets "duly" transferred to it and its obligations "*duly*" assumed in a tax-free transaction in which no gain or loss was recognized. The executors were "*duly*" released from the liabilities. They sold certain preferred shares of the Estate Company but distributed in kind to the legatees most of the shares of the Estate Company. They did not distribute to the legatees any of the assets or liabilities taken over by the Estate Company. Shortly after such transfers Mather's estate was wound up and the executors discharged. In December 1938 the Estate Company "duly adopted and carried out" a plan of complete liquidation in accordance with Section 112 (b) (7) of the Revenue Act of 1938 (which by the terms of that Act could have been done only by a real corporation with the concurrence by formal agreements of real stockholders). By the formal agreements in that connection there was "duly" transferred to petitioner assets of large stipulated value, and, by formal contract with the company and its creditors, petitioner duly and without limitation

assumed its share of the obligation on the Accommodation Note and other secured obligations. In 1939 petitioner paid some $49,000 of its own money on the Accommodation Note and deducted as a bad debt the amount for which Bishop thereby became indebted to it. Mather's executors and estate which had long since been wound up did not make such payments and acquired no debt against Bishop.

Nevertheless, the Circuit Court affirmed the finding of the Tax Court that "the petitioners may claim no position other than that of residuary legatees" and that their right to a deduction for a bad debt was to be determined as if Mather's estate had been administered in customary manner, his debts paid by the executors and the net residue distributed by them to petitioner.

The Circuit Court's summary of the Tax Court's conclusion (R. 201, 202), which it affirmed, is printed in the margin for the convenience of the Court.*

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* "* * * The tax court assumed that the legal relationship which arose as between Mather and Bishop, was that Bishop was accommodated by Mather and that the latter had a right over against Bishop immediately upon, but not until his response under the note. It also assumed that when the note was given Bishop was solvent, and it found, as a fact, that Mather did not make a gift to Bishop as a consequence of the transaction. It concluded, however, that notwithstanding the rather elaborate and unusual method adopted and carried out in connection with the payment of Mather's debts and the distribution of his estate, *the petitioners may claim no position other than that of residuary legatees of the estate*, and do not stand in the place and stead of Mather. Their status is not analogous to that of an assignee succeeding to the rights of his assignor and subject to his liability. *Residuary legatees have no interest in a decedent's estate other than the right to receive their allotted interest* therein after the payment of all charges imposed by law and by the testator in the way of specific bequests and annuities, and that among the charges imposed by the law are the debts of the testator to which his whole estate must respond under applicable Ohio law. The duty to discharge such debts rests upon the executor. *Had Mather's estate been administered in the customary manner the petitioners would have made no payments upon the joint note, for the indebtedness would have been discharged before any rights in the estate had ripened in their behalf and before receipt of their distributive shares.*"

The Circuit Court's own conclusions (R. 203, 204) are summarized in the following:

> "The net result of the whole arrangement, realistically viewed, is that the petitioners received their interest in the Mather Estate as residuary legatees even though distribution had been postponed by an arrangement which had no purpose other than to save them from a forced liquidation in an inopportune period. The entire transaction, whatever its form, was essentially, in intent, purpose, and result, the protection of creditors and the residuary legatees in their rights respectively to the assets of the estate, and whatever may have been the transitory legal title to such assets, either in the Executors, in the corporation, or as represented by stock, the purpose of the mechanics adopted was the payment of Mather's debts and the distribution of his property to legatees under the will * * *.
>
> "That corporate ownership extended over a term of years does not deprive such ownership of its transitory character. The period of corporate life was controlled by the economic necessities of the times, and not by the unfettered will of the parties interested. It, therefore, in our judgment, is immaterial that in achieving without loss the payment of Mather's debts, in saving the interests of the legatees in the estate, such interests were, for a time, transformed from bequests to corporate stock and then from corporate stock to corporate assets. *What the petitioners received,* over and above what they paid out, *were legacies provided by the will of Mather* and *it is unimportant whether Mather's debts were paid by the executors, the corporation, or the legatees.* * * *"

All this in spite of the fact that the Court said (R. p. 202):

> "The petitioners, however, insist, and *the tax court concedes,* that Mather's estate was *not* so administered; that the manner of administration was forced upon them by urgent financial and business necessities; was adopted in good faith without tax-dodging

purpose, and *that the deductions claimed are precisely those which would have been allowed to Mather if he had lived, or to the estate if it had continued to administer.*"

Thus, in one breath it is conceded that Mather's estate was not administered in customary manner and in the next it is said that all of the stipulated realities are to be disregarded and petitioner taxed "as if" Mather's estate had been administered in customary manner.

From 1934 on the executors, the probate court, the Estate Company, its creditors and its stockholders, the Commissioner of Internal Revenue and all other parties concerned, dealt with the stipulated actualities as actualities. Based on such actualities large amounts of property were held and transferred; debts were paid; the corporation and stockholders made tax returns, the executors made their final tax returns and were discharged; the statutory corporate liquidation was "duly" carried out with the necessary agreements of the stockholders (as corporate stockholders) with reference to the tax consequences thereof. (See Section 112 (b)(7) and the Commissioner's regulations thereunder; CCH 1939 Federal Tax Service, pars. 734B to 734I, inclusive.)

If the real substance and actuality of these transactions was that the executors liquidated the estate and distributed the net assets to the legatees, what is to happen to all of the executors', the Estate Company's and the stockholders' tax returns for these five years?

If the real "substance of the thing done" was, for the purpose of now governing the stockholders' tax returns, a customary administration of Mather's estate, then that must have been the real substance of the thing done for the purposes of the tax returns of the executors and the Estate Company and for the stockholders in connection with the liquidation under Section 112 (b)(7). No such liquidation occurred. The stockholders' agreements under

that statute are fictitious,—as is the Commissioner's stipulation.

"Substance" is the real, legal and practical actuality of "*the thing done.*" It is not (under this Court's decisions) what the Commissioner, the Tax Court or a reviewing Court may determine to be *a substantive equivalent of what was done.*

If the rule is now to be changed from "*the substance of the thing done*" to what the Commissioner or a court may determine to be a *substantive equivalent of the thing done,* then endless confusion and uncertainty will be injected into the administration of the tax laws. In almost every business transaction the general purpose and result sought can be legally and properly accomplished in a variety of ways. A trust, partnership or syndicate can often be substituted for a corporation or vice versa. All of a corporation's assets can be purchased or its stock can be purchased. Estates can be liquidated into net cash or assets can be distributed in kind, with or without full satisfaction of the estate's obligations depending upon creditor's consent.

If, after a definite, legal and proper procedure (not a sham procedure or one adopted for tax dodging purposes) is decided upon and "duly carried out" by a taxpayer, and the Commissioner so stipulates, we must still await the varied determinations of the Tax Court and a reviewing Court as to what taxpayer might have done to accomplish the same purpose and result (the substantive equivalent of what he did do), the variations and uncertainties in tax results will be limited only by the scope of the imaginations of the judges who consider the matter.

We submit that this Court, when it adopted the rule of "substance versus form," intended to sanction no such result.

We also submit that the decision of the Circuit Court (holding as it does that the "substance of the thing done"

"was essentially" the payment of the debts of the estate by the Executors and the distribution of the net proceeds to "the residuary legatees" as "legacies provided by the will of Mather" when, under the stipulated actualities, the Executors did not do so, and petitioner alone made the payment on the Accommodation Note and acquired the debt against Bishop here in issue), is in conflict with the decisions of this Court in the *Eisner* and *Phellis* cases, *supra*, and should be reversed.

The Circuit Court's disregard of the stipulated actualities is also in direct conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in the *McDonald* case, *supra*, and in the *Henrietta Mills* case, *supra*—its disregard of the stipulated existence and "duly" effected transactions of the Estate Company being in particularly direct and irreconcilable conflict with the decision in the *McDonald* case.

B. On the Stipulated Record (Disregarding the Fictitious Substance Created by the Courts Below) Their Decision is in Conflict with Established Law and Decisions of Other Circuits.

Section 23 (k)(1) of the Internal Revenue Code allows, in simple unconditional form, to all taxpayers, deduction for worthless debts. The deduction is not limited to particular classes of taxpayers, nor to business or other particular kinds of debts. (5 *Mertens Law of Federal Income Taxation*, 1942 (Sec. 30:01).)

The basic problem "is to determine whether the taxpayer is owed a debt" or whether the transaction involved a gift or a voluntary payment under which no debt to it arose. *Mertens*, Sec. 30:01; Sec. 30:04.

> "If there is a debt in fact and in law, the taxpayer will not be denied the deduction because the loan is not a 'wise' loan."
>
> *Mertens*, Sec. 30:10.

The undertaking of an accommodation obligation as maker or endorser gives rise to no debt from the accommodated party, but such debt does arise when, but not until, the accommodation party makes payment on the accommodation debt.

Bendey v. Townsend, 109 U. S. 665 (1883);
Wheeler v. Young, 193 Mass. 143 (1886);
Runkle v. Pullen, 49 Indiana Appeals 616 (1912);
Grygiel v. Maroille, 51 R. I. 109 (1930).

The same is also the law where the payment is made by the successor in liability to the accommodation party.

Burton v. Slaughter, 67 Va. 914 (1875);
Nelson v. Close, 147 Md. 214 (1925).

In the instant case it cannot be, and is not, questioned that a debt from Bishop to petitioner arose when petitioner, in 1939, made the stipulated payments on the accommodation debt. That such a debt did so arise in fact and in law is demonstrated (a) by the foreging principles which caused it to arise as a matter of law, it being expressly stipulated that "no gift was made or intended"; (b) by the formal contract with Bishop confirming his primary liability and his agreement to repay with interest any amounts paid on the accommodation obligation by the Estate Company or its successors; and (c) by the concessions of the Tax Court, confirmed by the Circuit Court,

> "that the deductions claimed are precisely those which would have been allowed to Mather if he had lived, or to the Estate if it had continued to administer." (R. 202.)

And by the Circuit Court's finding:

> "The petitioners contend that Mather was simply an accommodation maker of the joint note executed by himself and Bishop; that as such he had an inchoate right to recover from Bishop any amount which he might be required to pay thereon; that the petitioners

> succeeded to that right; that it was brought to fruition by the payments made by them in 1939; and that Bishop being then insolvent, they became, immediately upon payment, entitled to a bad debt deduction. *As to the steps in this rationalization, short of its final conclusion, there is no controversy.*" (R. 201.)

The Circuit Court of Appeals for the Second Circuit, in *Shiman v. Commissioner*, 60 Fed. (2d) 65 (1932), held that the right of an accommodation party to take deduction for the debt due him which arises when he makes payment upon an accommodation obligation, is in no way destroyed or restricted by the fact that the debt may be worthless when it arises.

In the thirteen years that have elapsed since the decision in the *Shiman* case, *supra*, the rule there laid down has been consistently applied by the Board of Tax Appeals and by other Federal Courts.

That a transferee taxpayer, who has assumed an obligation, is not to be taxed with respect thereto on a different basis from other taxpayers where the statute providing for the deduction in issue does not provide for any different treatment of a transferee, is now expressly confirmed by the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner v. Breyer* and companion cases, *supra*.

In the instant case the Circuit Court made a collateral attempt to distinguish the *Shiman* case on the ground that petitioners were not in Mather's position because their assumption of the accommodation debt

> "was tied to and limited by their distributable share in corporation assets, and such assets were the actual or converted assets of the Mather estate and none other." (R. 203.)

To the extent that this involves the fictitious assumption that Mather's estate paid the Accommodation Note and distributed the net assets, it is discussed under "A" above.

To the extent that it might otherwise indicate a finding that petitioner's assumption of the accommodation obligations in connection with the 1938 liquidation of the Estate Company was so limited, it is flatly contrary to the stipulated record and supported by nothing in the record.

It is stipulated that the Estate Company "was completely liquidated under and pursuant to a Plan of Complete Liquidation duly adopted and carried out * * *." (R. 50. *Section 1* of that Plan (R. 114) expressly provided for the execution and delivery of a necessary Amendment to the Mortgage Trust Indenture, which secured the payment of the Accommodation Note and other notes of the Estate Company, by the Company's common stockholders (including the petitioner). (Ex. I to Plan, R. 116.)

Section A of that Amendment (R. 118) provided—

> "Each of the parties of the Third Part (petitioner and others) hereby assumes and agrees, for the benefit of the holder of each note secured by said Indenture, to pay that proportion of each debt and obligation of the Corporation represented by each note secured by said Indenture, or under or arising from said Indenture as hereby supplemented and amended, as the number of common shares of the Corporation held by him is to the total number of the common shares of the Corporation as set forth in Recital 2 hereof." *

It is thus clear that petitioner's assumed liability with respect to the Accommodation Note was in no way qualified, or limited to its distributive share of the assets of the Estate Company. It had to pay what Bishop didn't, even if it took every asset it owned.

If the Court below intended to go beyond its fictitious reconstruction of "the thing done," it is possible that it was misled by *Section 4* of the Plan of Liquidation (R. 114) in which it was *also* provided that each common stock-

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* There were 1,000 shares of such common stock outstanding, of which 62½ were held by petitioner. (R. 117.)

holder should assume and agree to pay, "but only out of assets distributed to him," his proportion of *every* debt or obligation of the Estate Company. This was, of course, a limited assumption of the Company's *general liabilities. Its existence, however, could not and did not in any way, in fact or in law, impair or limit the full, personal, unconditional and unlimited assumption of the Accommodation* and other secured note obligations undertaken by petitioner *through its execution* with the Company and *its creditors* (in accordance with Section 1 of the Plan) of the Amendment to the Mortgage Trust Indenture as above recited.

It is thus clear that neither reason given by the Circuit Court for departing from the established rule of the *Shiman* case finds support in fact, form or substance of the thing done.

The basic provision of Section 23 (k)(1) for the allowance to all taxpayers of deductions for worthless debts has stood in the Internal Revenue Code without material amendment for many years. It has been applied to all taxpayers without distinction and subject only to the basic test,—Was there in fact and in law a debt owed to taxpayer and did it become worthless? In re-enacting such provision of the Code, Congress has re-affirmed such interpretation.

Similarly, the basic rule laid down by this Court in the *Eisner* and *Phellis* cases, that the Internal Revenue Laws are to be applied to the actual, existing substance of "*the thing done,*" has been accepted by Congress by its repassage of the Internal Revenue Laws without change in this regard.

The decision of the Court below in the instant case either (1) throws unlimited confusion into the interpretation and application of this rule of substance, or (2) it creates equal confusion and uncertainty as to the meaning and application of the simple provision of Section 23 (k)(1).

Actually, as the decision stands, it is clearly and directly in conflict with the decisions of this Court and with those of other Circuit Courts on the rule of substance; and, unless that conflict is resolved in favor of the Court below, then its interpretation and application of Section 23 (k)(1) is in conflict with all previous decisions on the subject.

Various cases cited by the Court below as authority for its position are discussed in the appendix.

CONCLUSION.

Because the decision of the Circuit Court in the instant case is in conflict with the decisions of other Circuit Courts, and because the Circuit Court has decided a federal question in a way in conflict with the applicable decisions of this Court, petitioner requests that its petition for a writ of certiorari be granted.

Respectfully submitted,

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Bldg.,
Cleveland 14, Ohio,
Telephone—Main 2905,
Counsel for Petitioner.

APPENDIX.

Cases Relied on by Circuit Court to Defeat Petitioner's Claim to a Bad-Debt Deduction.

Tulsa Tribune Co. v. Commissioner, 58 Fed. (2d) 937.

In this case three men agreed to organize a corporation and furnish it the necessary capital to buy a Tulsa newspaper. One of the promoters negotiated the purchase with funds in part advanced by the three and in part borrowed for the purpose. The corporation was then organized, took the property, and issued its stock for the money advanced by the promoters and assumed their debt for the money borrowed. The Court held (citing numerous cases) that, in so acting, the three promoters were in law and in fact the agents of the new company so that, upon its organization, their acts became the acts of the new company, and that the corporation had, therefore, paid cash for the property and issued its stock to the subscribers for the money advanced by them for its account.

This was not a holding that, if three individuals owned property and contributed it to a corporation for its stock, the transaction might be held in "substance" to have been that they paid cash for the stock and the company paid them cash for the property because the net result in substance would have been similar.

To make the situation in the case at bar analogous to that involved in the *Tulsa Tribune Co.* case, it would have been necessary for the Courts below to have found that Samuel Mather Estate, Inc. took the assets and liabilities from the Mather executors as their agent; that its stockholders took the same in 1938 and made their payments in 1939 as agents of the executors; and that then the executors and Probate Court distributed the net assets to the legatees under Mather's will,—although under the stipulated actualities all of the transfers were "duly" made; the statutory corporate liquidation was "duly carried out"; the execu-

tors were discharged; the legatees had accepted shares of the Estate Company in full satisfaction of their claims against the Estate and some of them had disposed of all or part of their stock in the Estate Company; and everything in the record indicated that the Estate Company had been organized to hold the assets in perpetuity and only liquidated because of the difficulties which later developed and for the relief of which Congress included in the 1938 Revenue Act the special liquidation provisions of Section 112(b)(7).

Commissioner v. Ashland Oil & Refining Co., 99 Fed. (2) 588;
Prairie Oil & Gas Co. v. Motter, 66 Fed. (2d) 309.

In each of these cases a company desired to acquire *certain* assets of another corporation. The transferor corporation was therefore stripped of its other assets and the stock of the transferor was assigned to the transferee upon payment in cash of the price agreed to be paid for the property. The transferor was thereupon immediately liquidated and its assets transferred to the acquiring company. It was held in each case that the transaction was not a tax-free reorganization and that the tax base of the acquired assets in the hands of the purchasing company was the price it paid for the stock. While the opinions contain some interesting discussion of the rule of real "substance," they are in no way authority for disregarding real, actual, functioning, corporate entities, or for substituting the "substance of what might have been done" for the "substance *of the thing done.*"

To make those decisions applicable to the Mather situation, it would have been necessary for the Tax and Circuit Courts to have found that Mather's estate was administered in the customary manner (when in fact it is conceded by both Courts that such is not the case), and that Samuel Mather Estate, Inc. was only a sham and a fiction

and it and its stockholders were only an agency of the executors and the Probate Court and that such executors and court were in fact directing and conducting the Company's business and the actions and payments of its stockholders for years after the estate was closed.

Ahles Realty Corporation v. Commissioner, 71 Fed. (2d) 150.

In this case a corporation, all of whose stock was owned by one Snyder as trustee, transferred all of its assets to petitioner in exchange for all of petitioner's stock and income debenture bonds. The transferor corporation was subsequently liquidated and the securities of the petitioner ultimately passed to Snyder. Upon the subsequent sale by the petitioner of the property so acquired, the Commissioner took the position that the basis for determining gain or loss realized upon the sale was the cost of the property to the transferor corporation, while petitioner contended that such basis was the fair market value of the property at the date of acquisition. The Court held that the transaction was in substance a reorganization of the transferor corporation and not in truth or in fact a sale of the property involved.

Here again neither the holding, nor the language of the opinion, enlarges the rule of "substance of *the thing done*" to include, as *done*, things found not to have been *done*.

Helvering v. Clifford, 309 U. S. 331.

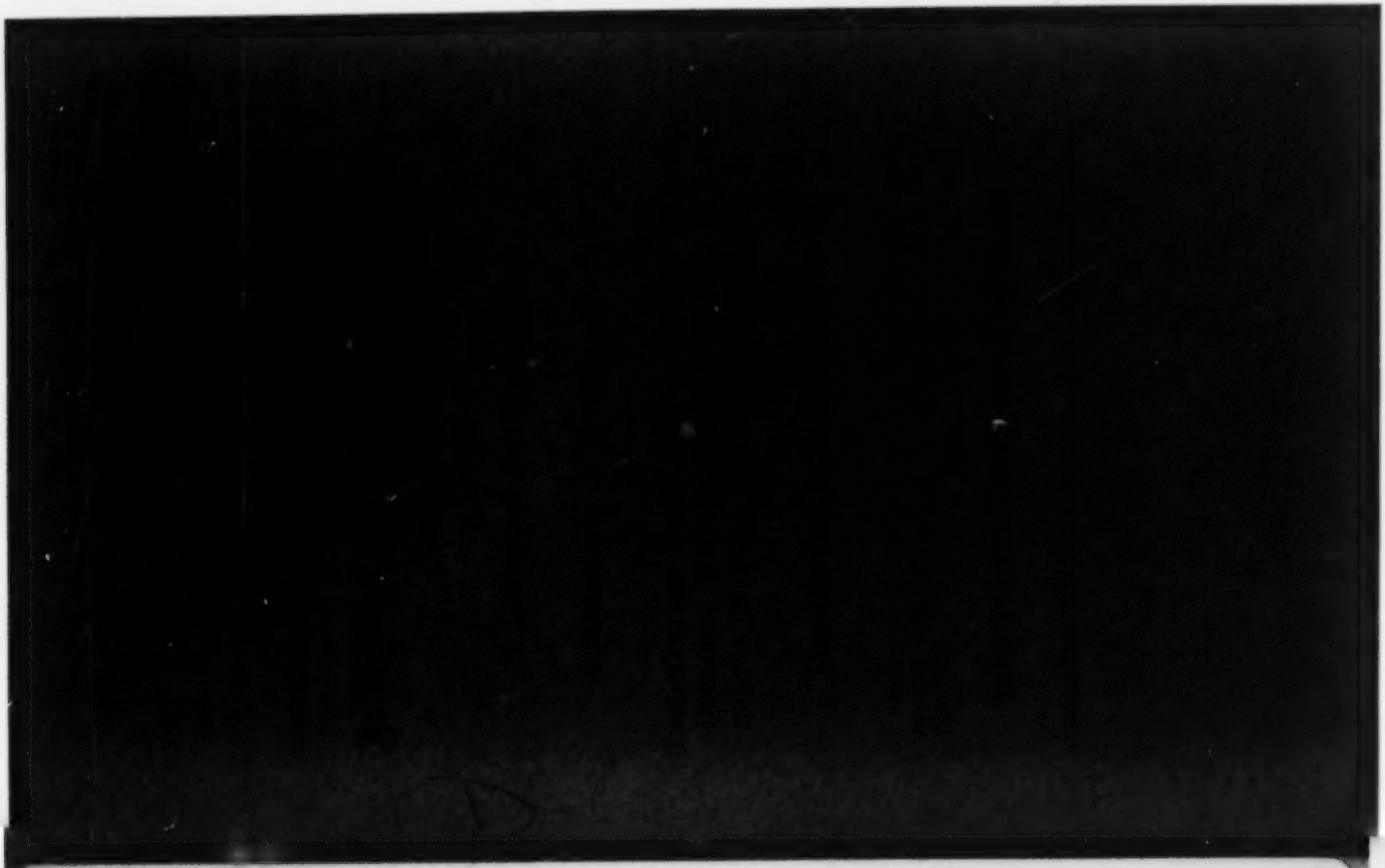
Here a husband had declared himself trustee for five years of certain of his own securities to pay the income to his wife during such period. The Supreme Court held that he "continued to be the owner" of the securities, that he "retained the substance of full enjoyment of all the rights which previously he had in the property" and that it was not reversible error for the trial court to find that

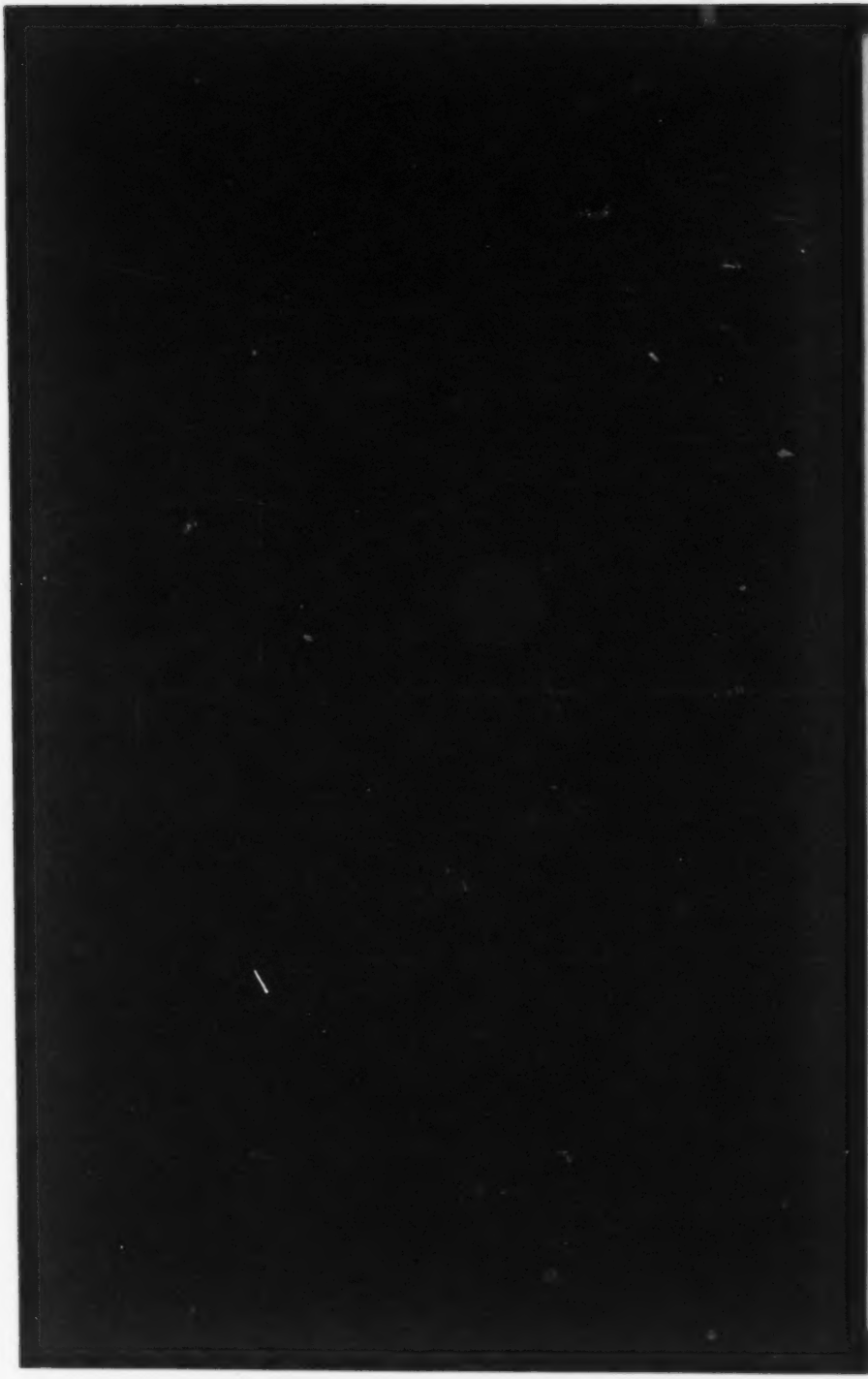
"the husband was the owner of the corpus." Being the owner, he, and not the trust, was accordingly taxed on the income.

This was *not* a holding that, although the husband was not the owner, he was to be taxed on the income as if he had been the owner.

To make the instant case fit such holding, it would have been necessary for the Tax and Circuit Courts to have found that the executors continued to own the Mather assets throughout the life of the Estate Company and while they were in the hands of, and the income from them was being taxed to, the stockholders; that the stipulated statutory corporate liquidation did not occur; and that the executors and not petitioner, in substance and in fact, made the 1939 payments on the accommodation note from funds of the closed estate.

The Tax and Circuit Courts did not so find. They found in substance and in fact just the opposite. But both Courts held that petitioner should nevertheless be taxed as if they had so found.





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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 455

S. LIVINGSTON MATHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 456

TESTAMENTARY TRUST U/W OF SAMUEL MATHER, DECEASED, WILLIAM G. MATHER AND S. LIVINGSTON MATHER, TRUSTEES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court's opinion (R. 175–184) is unreported. The opinion of the Circuit Court of Appeals (R. 199–205) is reported at 149 F. 2d 393.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered May 23, 1945. (R. 197, 198.) A petition for rehearing was denied July 2, 1945. (R. 207.) Separate petitions for writs of certiorari were filed September 26, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayers were residuary legatees of the estate of a person who, as accommodation comaker, had executed a joint note with his son-in-law. The estate's assets were transferred to a corporation which assumed the debts, and later, on dissolution of the corporation, its assets were distributed to the taxpayers in proportion to their original interests in the estate subject to payment of the decedent's debts, including the liability on the joint note. The son-in-law was insolvent at the date of the decedent's death and at all times thereafter.

The question is whether the taxpayers are entitled to bad debt deductions under Section 23 (k) of the Internal Revenue Code equal to their payments on the note.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 23 [as amended by Section 124 of the Revenue Act of 1942, c. 619, 56 Stat.

798]. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) *Bad Debts.*—

(1) *General Rule.*—Debts which become worthless within the taxable year; * * * (26 U. S. C., Sec. 23.)

STATEMENT

These proceedings were consolidated in the Tax Court and in the court below. The pertinent facts were summarized by the Tax Court as follows (R. 176–179):

Petitioners were residuary legatees under the will of Samuel Mather who died testate on October 18, 1931, a resident of Cuyahoga County, Ohio. (R. 176.)

Prior to June 1, 1931, Robert H. Bishop, Jr., the husband of Mather's daughter, Constance, had become financially involved. Mather loaned Bishop securities which the latter pledged with a brokerage firm as security for his account there. Still the account was short and the brokerage firm threatened to liquidate the collateral. To protect his securities so pledged by Bishop and to provide Bishop with funds to meet his various obligations, Mather arranged a loan at the Guardian Trust Company of Cleveland, Ohio, in the amount of $3,566,000. The loan was evidenced by a joint and several promissory note executed and delivered by Mather and Bishop, dated June

1, 1931, due one year from date and secured by collateral having a market value of approximately $4,650,000. Of the securities so pledged, $500,000 worth belonged to Bishop, $1,750,000 worth belonged to his wife and $2,400,000 worth belonged to Mather. The proceeds of the loan, plus $130.24 in cash furnished by Bishop, were disbursed by the bank in payment of Bishop's debts including that in favor of the brokerage firm. The securities owned by Mather which were pledged to it were surrendered and became a part of the collateral provided by Mather to secure the joint note. Mather did not make a gift to Bishop as a consequence of the above described transaction. (R. 176.)

No payment having been made on the principal of the joint note prior to Mather's death, a claim was filed and allowed against the Mather estate in the face amount of the note. Bishop, at the time of Mather's death, was insolvent and wholly unable to pay any amount on any unsecured obligation owed by him and he has been so ever since. The executors of the Mather estate and the Commissioner engaged in a controversy over the amount of the federal estate tax due. As finally settled, the estate was allowed as a deduction in computing the value of the net estate the amount of the joint note plus interest accrued to the date of death less the value of the pledged securities belonging to Bishop and his wife, or $2,281,944.23. (R. 176–177.)

In order to provide time for the ultimate payment of obligations of the estate and thus avoid a disastrous liquidation and to provide for the distribution of assets to the legatees under Mather's will, a corporation, Samuel Mather Estate, Inc., was created and a contract was executed by the interested parties on November 13, 1933, calling for the acquisition of the estate's assets by the corporation subject to all debts and liabilities of the estate in the order of their priority in exchange for stock. The corporation agreed to issue jointly with Bishop Series A collateral trust notes in an aggregate principal amount equal to the balance due on the joint note plus interest to December 31, 1934. It also agreed to issue Series B collateral trust notes in an amount sufficient to settle the unsecured obligations of the estate. Both series of notes were to be issued pursuant to a trust indenture. The corporation's assets were to be deposited and pledged with the trustee under the trust indenture as security for the payment of the notes. This contract was approved by the Probate Court of Cuyahoga County, Ohio, and its terms thereupon were carried out. The executors of Mather's estate duly transferred to the corporation all the property and assets of the estate in a tax-free exchange whereby they received 11,465 shares of the corporation's Class A preferred stock, 4,000 shares of its Class B preferred stock, 4,000 shares of its Class C preferred stock and 1,000 shares of its common stock. The

Class B preferred stock was distributed in a way not here material. The Class A preferred, the Class C preferred and the common stock were distributed to the various legatees under Mather's will in proportion to their interests in the estate. Class A preferred was distributed to specific legatees and Class C preferred and common stock was distributed to the residuary legatees including the petitioners herein. Petitioner in No. 455 received 1,000 shares of Class C preferred and 250 shares of the common. Petitioners in No. 456 received 250 shares of Class C preferred and 62½ shares of the common. The corporation assumed the payment of the debts, obligations and liabilities of the Mather estate including its obligation on the joint note. Among the assets of the estate so transferred to the corporation were the securities which had been pledged as security for payment of the joint note. They were transferred subject to such lien. The Series A notes, due December 31, 1939, were delivered to the holders of the joint note in the way of additional evidence of the indebtedness, the holders of the joint note thereby agreeing to make no demand for payment of the joint note unless the Series A notes fell into default. The Series B notes, also due December 31, 1939, were delivered to the unsecured creditors of the estate and accepted in full payment of their respective claims (R. 177–178.)

Coincident with the transfer of the estate assets to the corporation, an agreement was made by and between the executors of the estate, the corporation, Bishop and Constance wherein Bishop acknowledged and agreed that the joint note had been executed by Mather as an accommodation to him; that he was indebted to the executors for the interest and principal which they had paid on the joint note; and that he would thereafter be indebted to the corporation in this amount plus all further payments which the corporation would make on the joint note and the Series A notes to be issued by it and Bishop jointly. The executors, by the same instrument, assigned their claim against Bishop to the corporation. Constance agreed that the securities belonging to her and pledged to secure the joint note might be applied toward payment of the joint note. (R. 178.)

In December, 1938, a plan of complete liquidation of the corporation was adopted and effectuated to have the benefit of the provisions of Section 112 (b) (7) of the Revenue Act of 1938. As a consequence, the petitioners received their pro rata share of the assets of the corporation in kind, subject to all existing liens thereon, in complete cancellation and redemption of their stock in the corporation. In accordance with the plan petitioners, as well as the other common stockholders of the corporation, agreed to assume

the payment of the corporation's debts in proportion to their common stock holdings, but only out of the assets transferred to them in exchange for their common stock or any other property into which such assets might be converted. Thus petitioners in Nos. 455 and 456 assumed the payment of ¼ and 1/16 of each debt, respectively. Among such debts was the unpaid balance due on the joint note in the amount of $1,403,715.22. (R. 178–179.)

The collateral owned by Constance was sold and applied in reduction of the balance due. During the taxable year, 1939, petitioners in Nos. 455 and 456 paid, respectively, $120,145.35 and $48,898.98 on the joint note. The fair market value of the properties received by the petitioners upon the liquidation of the corporation was many times greater than the portion of the indebtedness on the joint note which they assumed and agreed to pay and was in excess of the fair market value of their share of the Mather estate as of the date of Mather's death. The aggregate value of the securities distributed by the corporation to the stockholders less the debts assumed by the latter exceeded the net estate of Mather upon which was based the federal estate tax. (R. 179.)

The petitioners claimed bad debt deductions under Section 23 (k) of the Internal Revenue Code on the theory that Bishop became indebted to them to the extent of their payments on the

joint note and that the debts so created instantaneously became worthless by reason of Bishop's insolvency. (R. 179.) The Tax Court sustained the Commissioner's disallowance of the claimed deductions (R. 184) and the Circuit Court of Appeals for the Sixth Circuit affirmed (R. 205).

ARGUMENT

The petitioners' claim below to a bad debt deduction under Section 23 (k) of the Internal Revenue Code, *supra,* relied mainly upon *Shiman* v. *Commissioner,* 60 F. 2d 65 (C. C. A. 2d) (R. 179, 202), and it is now asserted that the decision below is in conflict with that case. (Pets. 9, Brs. 20–24). The general rule, as approved by this Court, is that a bad debt deduction is not allowable where "the debt was worthless when acquired." *Eckert* v. *Burnet,* 283 U. S. 140, 141.

However, regardless of whether the *Shiman* case is to be treated as carving an exception out of the general rule, it is inapplicable here, as amply demonstrated by the opinions of both courts below. The income tax liability of an accommodation maker of the note is not involved. The taxpayers here are residuary legatees, entitled to a specified portion of the decedent's estate *after* the payment of all debts, charges, etc. But the mere fact that distribution occurred *before* payment of the debt, thereby increasing the gross amount receivable by the residuary legatees, can-

not be made the means whereby those legatees obtain income tax deductions upon payment of the debts out of the distributed property. No such question was present in the *Shiman* case.

Nor is the decision below in conflict with *Commissioner* v. *Breyer,* C. C. A. 3, decided August 31, 1945 (1945 C. C. H., par. 9398) which involves a claim for deduction for interest with respect to the tax liability of a decedent's estate that was discharged out of assets of the decedent in the hands of a legatee. The court in that case distinguished between interest which had accrued up to the date of distribution to the legatee and interest accruing thereafter; the deduction was allowed only as to the latter. A companion case, *Commissioner* v. *Koppers,* decided in the same opinion, raising the same question as between predecessor and successor corporations makes clear that those cases involve special problems relating to transferee liability under the tax laws.[1] Moreover, the *Breyer* opinion does not purport to depart from the fundamental principle, controlling here, that income tax deductions cannot be predicated upon the payment by one taxpayer of the obligations of another, voluntarily assumed.

---

[1] The Government intends to petition for certiorari in the *Breyer* and *Koppers* cases in view of the square conflict which exists between the decision therein and *Nunan* v. *Green,* 146 F. 2d 352 (C. C. A. 8); *Commissioner* v. *Henderson's Estate,* 147 F. 2d 619 (C. C. A. 5); *Commissioner* v. *Green,* 148 F. 2d 157 (C. C. A. 9).

Interstate Transit Lines v. *Commissioner,* 319 U. S. 590; *Deputy* v. *du Pont,* 308 U. S. 488; *Welch* v. *Helvering,* 290 U. S. 111.

Eisner v. *Macomber,* 252 U. S. 189 and the other remaining decisions relied upon by petitioners are far removed from the present controversy.

CONCLUSION

The decision below is correct and no conflict in decisions is presented. It is respectfully submitted that the petitions for writs of certiorari should be denied.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
HAROLD C. WILKENFELD,
Special Assistants to the Attorney General.

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In the Supreme Court of the United States

OCTOBER TERM, 1945.

No. 455.

S. LIVINGSTON MATHER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

No. 456.

TESTAMENTARY TRUST u/w OF SAMUEL MATHER, DECEASED, WILLIAM G. MATHER AND S. LIVINGSTON MATHER, TRUSTEES,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Building,
Cleveland 14, Ohio,
Counsel for Petitioners.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—MAIN 5647

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In the Supreme Court of the United States

OCTOBER TERM, 1945.

No. 455.

S. LIVINGSTON MATHER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

No. 456.

TESTAMENTARY TRUST u/w OF SAMUEL MATHER, DECEASED, WILLIAM G. MATHER AND S. LIVINGSTON MATHER, TRUSTEES,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

ERRORS IN FACTUAL STATEMENTS.

The following will correct certain misstatements of fact as contained in Respondent's Brief under "Question Presented" and "Statement."

1. Taxpayers were not "residuary legatees" of Samuel Mather, either at the time the Estate Company was liquidated in 1938 or in 1939, the income tax year here in question. Years prior to 1938, all rights of residuary legatees of that estate had been fully satisfied, the estate wound up, and the executors discharged. Thus, at all times here in question, taxpayers were not residuary legatees of such estate.

2. The assets distributed by the Estate Company in its statutory liquidation in December of 1938 were not assets of the estate but were assets which, under the express terms of the stipulation, belonged wholly and completely to the Estate Company.

3. Such distribution was not then made "to the taxpayers in proportion to their original interests in the estate subject to payment of decedent's debts." The distribution was to *the corporation's stockholders in proportion to their stockholdings* and subject to the remaining debts *of the corporation*. It is expressly so stipulated. (R. 40, 114.)

4. The stocks issued by the Estate Company did not "correspond" with the interests of the legatees in the estate even at the time of their original issuance, as some were sold by the executors and some were issued in connection with the corporation's refinancing of its obligations. At the time of the 1938 distribution the relationship had been further broken as Mrs. Bishop had turned in $1,000,000 of Class C Preferred to the corporation to apply on Bishop's obligations to it and there had been transfers of other stockholdings, including one of common stock. (R. 39, 95, 96, 117.) There was no restriction on such transfers by taxpayers.

(*Query:* Is the decision below to be applied to a stockholder who was never a legatee? Are taxpayers to be penalized because they were legatees and did not sell?)

5. In spite of implications to the contrary in Respondent's statement, Bishop was not insolvent when Mather first loaned his collateral to Bishop, and it is expressly stipulated and found that neither in making such loan nor in the execution of the accommodation note was any gift made or intended. (R. 36.)

6. Mather's estate tax was compromised by a lump-sum settlement and the Board of Tax Appeals' dollar judg-

ment. Memoranda prepared in connection with such settlement included a deduction from values for the then estimated outcome of Mather's accommodation liability on the Bishop note; but there was never any determination by the Commissioner or finding by the Board allowing such deduction.

7. The stipulated record shows that the Estate Company was formed and the estate's assets and liabilities were duly transferred to it in order (a) *"to prevent"* the disastrous liquidation of the estate; and (b) to accomplish the present satisfaction of its obligations and the prompt discharge of the executors. (R. 84-85, 96 Sec. XIV.) It was not "to provide time for the *ultimate* payment of obligations of the estate" and the distribution of its "assets to the legatees under Mather's will." There is not the slightest suggestion in the record of an intent to extend the estate's activities or carry them out through corporate form. Inherent in every provision of the agreements and the stipulations is the duly accomplished purpose to permanently reset the situation in actual corporate form and promptly, completely and finally close the estate and all of its activities and relationships. In a dozen paragraphs of the stipulation the Commissioner has agreed to and confirmed the due and complete actuality and finality of the steps so taken. Neither in conference or before the Tax Court did he ever contend otherwise. It will indeed be making new law if he can now support the fictitious conception of these stipulated actualities invented by the Tax Court and affirmed by the Circuit Court.

8. It is not true that taxpayers agreed to assume payment of the accommodation obligation "only out of the assets transferred to them in exchange for their common stock * * *." Their assumption of such obligation was full, personal, unconditional, necessary and direct to the creditors. (See our Original Brief pp. 23, 24.)

ARGUMENT.

Respondent here continues his tactics (successfully employed in the courts below) of avoiding the real issues by implying other issues (without developing them) in the hope that space will not permit an answering analysis and the court will seize thereon to support Respondent's unsound position.

Petitioners below did not rely "mainly" upon *Shiman v. Commissioner*, 60 F. (2) 65. They relied mainly upon the unconditional provisions of Section 23(k)(1), I. R. C., and the proven and admitted fact that their 1939 payments created debts from Bishop to them, in law and in fact, and that such debts became worthless.

In their effort to meet one of the varied and shifting grounds then advanced by the Commissioner to justify his denial of the deductions claimed, they used the *Shiman* case for exactly what it held, namely: that where the bad debt arose from a required payment on a valid accommodation obligation, its deduction could not be denied because it was worthless when it arose.

If and to the extent that the deducted debt from Bishop was disallowed by the Court below because it was worthless when it arose, then such decision is in direct conflict with the *Shiman* case.

If the decision below is based only upon the fictitious substance that the Estate Company had no actuality and the executors paid the accommodation note and distributed the net estate to taxpayers,—then, of course, there is no conflict with the *Shiman* case and the conflict is with *Eisner v. Macomber* and its associated cases cited in our brief.

The *Shiman* case has nothing to do with such fictions, and petitioners never claimed it had.

At no time here involved were taxpayers "residuary legatees" with rights against Mather's estate. Any rights they had as legatees had been satisfied and the estate closed years before.

There is no effort here to utilize the transactions "to obtain income tax deductions" not otherwise allowable. If the estate had paid the accommodation obligation and distributed the net residue (as assumed by the Court below), it would have been entitled to the bad debt deduction. Petitioners only claim a similar right. Respondent's position seeks, by confusion, to deny the deduction to anyone. The executors cannot have it because they did not exist when the payments were made. Under the assumed fiction, petitioners cannot have it because the executors paid. It is the taxpayers, not the government, who are made to sit down between the chairs.

In Respondent's brief comment on *Breyer v. Commissioner*, C. C. A. 3, he implies that the decision below in our cases was in some way based upon the theory that petitioners were mere volunteers. This further illustrates the casual shifting of position by Respondent which has contributed to the fantastic conclusion reached below. The Tax Court, as will be seen from its opinion, added this volunteer theory to support its conclusion. The subject was briefed to the Circuit Court of Appeals and, of course, fell flat on analysis and was not used by that Court in the opinion sought to be reviewed here. Petitioners were in no sense, or under any decided case, volunteers.*

The *Breyer* and *Koppers* cases are in conflict with the instant decision in their holdings that a transferee is as

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* *Interstate Transit Lines v. Commissioner*, 319 U. S. 590, and *Welch v. Helvering*, 290 U. S. 111, referred to by Respondent in this connection, merely announce the principle that payments made by taxpayers to discharge debts of another for which taxpayers were not obligated did not, under the circumstances there involved, amount to ordinary and necessary expenses of the taxpayers' businesses. *Deputy v. DuPont*, 308 U. S. 438, holds that the expense to taxpayer of carrying stock borrowed in connection with short sales made by him did not, under the circumstances there involved, constitute ordinary and necessary business expense. These decisions can have no possible relevancy to any issue involved in the instant cases.

much entitled to deductions as a transferor, unless the section of the Revenue Act providing for such deductions contains a limitation to the contrary. They were cited originally by petitioners for that purpose.

Another aspect of the *Breyer* and related cases cited by Respondent has an interesting application here. In each of those cases the taxpayer took gross assets *direct* from an estate subject to estate tax debts which had not been discharged.

In summarizing and affirming the position of the Tax Court in our cases, the Court below said:

> "Had Mather's estate been administered in the customary manner the petitioners would have made no payments upon the joint note, for the indebtedness would have been discharged before * * * receipt of their distributive shares."

Had a similar fiction been indulged by the Court in the *Breyer* case (or the other estate cases), it would have said:

> "Had the estate been administered in the customary manner, Breyer (or the other legatees) would have made no payment on account of interest on the estate tax, for the indebtedness would have been discharged before * * * receipt of his distributive share";

and the question discussed at such length in the *Breyer* and such other cases (as to whether the legatees, who took direct distribution of the gross estate subject to tax debts, were paying interest on "their own debts") would not have been the decisive factor or possibly even discussed.

If, in the instant cases taxpayers (who, as stockholders of the corporation, received assets and assumed debts on a statutory corporate liquidation years after the winding up of Mather's estate) can be taxed as if the estate had paid the debts and distributed the net assets of the corporation as the net assets of the estate years after it was closed, certainly Breyer and the others, *who took*

gross assets direct from active executors should have been so taxed. The fact that such rule of fiction was not so applied in the *Breyer* and related cases brings them into conflict with the decision below in the instant cases. And the fact that the Commissioner *did not even suggest* the application of such rule of fiction in the *Breyer* and related cases clearly should, and does, make it embarrassing for him to attempt to support it here.

We agree with Respondent that *Eisner v. Macomber* and associated cases should be "far removed from the present controversy," in which the facts are clearly stipulated without question of their actuality. Nevertheless, the rule of substance which such cases announce was the essential premise of the decision below; and it is the fictitious application of that rule by the Court below (when the rule should be "far removed from the present controversy") which creates the principal conflict of decisions requiring review by this Court.

CONCLUSION.

For the reasons stated above and in their original briefs, petitioners request that their petitions for writs of certiorari be granted.

Respectfully submitted,

JOHN B. PUTNAM,
EDWIN A. HOWE,
1882 Union Commerce Building,
Cleveland 14, Ohio,
Counsel for Petitioners.